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ABSTRACT

This guidebook assesses the feasibility and potential impact a specialized lending program might have on the capital needs of community-based child and family services. It explains the need for quality facilities and how physical space can affect child care quality and the program's impact. Also described are the problems associated with capital loans for these services. The paper examines how facilities loan funds directly improve access to credit and how they can have broader indirect impact on the level of capital investment in community programs. Types of loan funds are examined, as are the characteristics of a lender's capital structure, lending policies, several start-up strategies, and capitalization loan strategies used by other institutions. Appendices provide a glossary, a proforma for the Child Care Capital Investment Fund (CCCIF), information from the Community Development Financial Institutions Fund, case studies of two sample CCCIF loans, a sample of a loan fund application, and a sample of loan program guidelines. A list of resources concludes the document. (Contains 16 resources.) (GR)

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Building for the Future:

A Guide to Facilities Loan Funds for Community-Based Child and Family Services

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by
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Introduction

Entering the school through a side door, you descend a short flight of stairs. Insulated pipes cling to the ceiling like stalactites. The masonry walls wear a dull standard-issue uniform of pea-green paint. A room halfway down the hall houses the family support center, sporting a high ceiling, four small basement windows high on the wall, a couch, toys, and a collection of desks, tables, chairs, and shelves. Is this a "welcoming" environment, a place parents might gravitate to and spend time at? Is this even very functional for the meetings, training sessions, consultations, and socializing that happens here? Probably not. The site's one virtue is its minimal cost. This one

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overriding economic consideration profoundly limits the ability of child and family service programs to meet the needs of those they are intended to serve. Recognizing the poor quality and scarcity of physical space currently dedicated to community-based child and family services, forward- thinking nonprofit leaders, government officials, foundation executives, and business leaders increasingly have begun to explore and, in some cases, to establish specially designed loan programs to supply capital to providers of these services, who may not be able to access credit from any other source.

Are facilities financing programs a logical response to these problems? Can the organizations or individuals providing community-based child and family services support debt? What kind of impact can a lender have on the capital problems of child and family service programs? Can a targeted lender affect programs in other ways, contributing to better management or even program quality improvement? How complicated is it to create and operate a loan program? How difficult is it to raise loan capital? This guide is designed to answer these and other questions that potential loan fund sponsors might ask themselves. This is not a "how to" operating manual that describes the procedures for underwriting, closing, and monitoring loans; rather it is a guide for policymakers, funders, program directors, and opinion leaders trying to expand and strengthen the system of supports and services for children and families. It tries to provide information, based on a growing experience from around the country, upon which to assess the feasibility and potential impact a specialized lending program might have on addressing the capital needs of those who deliver supports and services to children and families.

A Time of Opportunity

Why now? Why have loan funds gained currency as a policy strategy for improving the quality and supply of community-based child and family services? The answer is two-fold. First, there is a growing demand for child and family service facilities. Child care and pre-kindergarten funding has exploded:

- Expanded Federal child care and TANF block grants accompanied the passage of welfare reform legislation, so states are funding more child care subsidies.
- Head Start funding continues its three-decades-long expansion with more emphasis being placed on serving more children on a full-time, rather than the program's customary part-day, schedule.
- Many states, flush with tax revenue from this period of unprecedented economic expansion, have chosen to invest funds in pre-kindergarten programs to ensure that children enter elementary schools ready to learn and with a reduced need for costly special education services.
- Fewer families choose or can afford to stay at home to raise young children.

All of these trends stimulate demand for center-based early care and education programs and translate into the need for more facilities. Similar trends are fueling the expansion of family support services, albeit on a smaller scale.

- There has been a shift in the model of human service delivery away from the fragmented, provider-oriented, and bureaucratically managed service paradigm toward a more comprehensive, community-based, family-centered model that often

relies on programmatic collaborations. This paradigm shift has created the need for accessible community-based or school-linked "places" where families can seek and find support services.

- Welfare reform has provided a further impetus for comprehensive, family-centered program models designed to address the array of barriers that former welfare recipients face as they try to enter the workforce.
- Motivated by the current political demand for educational outcomes and, in some jurisdictions, the judicially imposed mandate to achieve greater educational equity, a number of states have incorporated family resource center models into pre-kindergarten and other programs.

Second, while these factors stimulate demand for more or different facilities, it is increasingly feasible to raise the capital needed to operate a facilities loan program.

- Over the past two decades, a modest nonprofit development lending industry has emerged in the United States. In recent years, many of these lenders have diversified from their original affordable-housing or small-business lending niche to address some of the other capital needs in lower-income communities.
- The Community Reinvestment Act (CRA) has motivated banks to think more about the credit needs of previously "red-lined" neighborhoods and to apply their capital and expertise to the job of crafting strategies for meeting the capital needs of these communities.
- The passage in 1994 of the Community Development Banking and Financial Institutions Act created a source of federal funding to capitalize community development financial institutions.
- Governmental and philanthropic funders are becoming increasingly sophisticated about capital needs and financial institutions.

These factors have combined to create a moment in history when the capital needs of community-based child and family support services have risen on the agendas of many individuals and institutions. It is also a time when the creation of loan funds is more feasible than at any time in decades. In short, a unique opportunity exists.

But how significant is the problem of facilities for community-based child and family services, and how effective are loan programs at addressing their capital needs? These are the first critical questions this Guide addresses.

Why Facilities Matter

Let's start with child care, where the role of facilities has received somewhat more attention and is therefore better documented. There is a growing shortage of child care facilities. Unlikely as it would be, one can imagine this topic in the hands of a late-night comedian like David Letterman, asking rhetorically, "Why aren't there more child care centers?" The punch-line, of course, is, "All the church basements are already in use."

Dark humor to be sure, but humor that perhaps reveals a deeper truth: that it is common practice to locate child care centers in facilities designed for some other use, especially church basements.

There is a deeper irony as well; as a society, we have come to think that the type of space we reserve in our homes for the furnace, laundry room, storage, and sawdust-filled workshop is somehow a logical environment for young children to spend much of the day when it is under a religious structure or public building. Of course, the reason so many child care centers locate in church basements is because there is no other use for the space. So it is cheap, perhaps even free, and available.

In addition to child care centers being in short supply, the quality of community-based child and family service facilities is frequently fair to poor. This impacts on the quality of these important community services. To be sure, a very substantial part of the facilities problem is economic; programs, especially governmentally and philanthropically supported ones serving lower-income communities, lack the revenue to pay the full cost of well-located and appropriately designed physical facilities. Well-situated street-level quarters constructed or renovated to meet the specialized programmatic needs of a family resource or child care center would be out of the question. The underlying fiscal problem is also evident in the notoriously low wages and paltry benefits offered to caregivers and the frequently inadequate level of administrative staffing evident in these programs; the prevalence of poorly located, low-cost "as-is" child care and family resource facilities is simply another manifestation of society's frequent unwillingness or inability to pay the admittedly high cost of delivering quality early childhood and family support services.

The underlying economic realities that created and sustain the facilities crisis have spawned some dysfunctional adaptations that have compounded the problem. For example, not only have parents come to accept basement-level child care space, many providers no longer aspire to better facilities. Basil J. Whiting has noted:

> ...that nonprofits...are concerned about "diverting" scarce funds from services to facilities that could be criticized by the community. In addition,...many boards and staffs of nonprofits have an often unspoken "hair shirt" mentality that they "should" be in poor facilities because they serve poor communities, that it is "normal" to have "cruddy" facilities, furniture, and equipment, even if their inadequacy impairs service delivery. Perversely or not, some see it as a kind of "badge of honor," something to [tolerate] with both resignation and pride for devoting themselves to the good works they do.

One might add to Whiting's list, a reluctance to invest in facilities when the staff remains so grossly underpaid.

Regardless of the causes, a facilities crisis exists in the family support and early care and education fields, and this crisis profoundly affects the *supply* and *quality* of these services in lower-income communities. These are the two critical dimensions of that crisis.

Supply

Recent empirical studies have demonstrated that child care supply correlates with income; the supply of both family day care and center-based care is greater in more affluent communities as compared with less affluent ones. The discrepancy is most pronounced for center-based care.

A recent U.S. General Accounting Office report, Welfare Reform: Implications of Increased Work Participation for Child Care, (May, 1997) concluded that the supply of center-based care is already insufficient, especially in poorer neighborhoods, and will grow worse as welfare reform proceeds. This is especially true because the federal block grants that accompanied welfare reform's enactment have allowed the states to subsidize more children than ever before, but limit the use of block grant funds for facilities. Many states have also begun to fund pre-kindergarten programs, often delivered by nonprofit child care providers. All of this expansionary pressure is occurring in a strong economy where the demand for real estate is strong, and therefore its price is especially high. With a limited supply of low-cost/ no-cost space – church basements and public facilities – in most communities, the relative shortage of child care, especially center-based child care, can be expected to grow more severe.

That shortage creates a very serious quality problem as well; parents will have fewer choices and will have to resort to either inferior-quality or higher-price care. Others simply won't be able to find care at all. According to the GAO, in Chicago, the supply of child care is only sufficient to accommodate 14% of the demand for infant care. The increased demand has presumably made the problem worse.

Studies demonstrate that quality early care and education stimulate important developmental gains for low-income at-risk children. Mediocre or poor quality care does not produce those benefits. In fact, such programs may even be detrimental to at-risk children. Thus, the shortage of center-based care often forces parents to cobble together less stable and lower quality services for precisely the group of children most in need of high-quality care. Thus, the shortage of supply has serious quality implications for children and compounds the challenges parents face trying to enter and stay in the workforce.

Quality

Two characteristics of physical space affect child care quality: *Inherent characteristics* of space and the *level of rehabilitation.*

Inherent Characteristics The inherent characteristics of space are hard to change. Basement locations with minimal natural light or locations inconvenient to public transportation are inherently undesirable characteristics for child care. Sometimes child care centers locate in residential structures, including apartments. Residential buildings are constructed around a relatively small grid of rooms. This is fine for the average family. But when it becomes child care space, too much of the space is devoted to circulation—"pathways" through these rooms. The many rooms make supervision difficult. Finally, the size and proportions of the rooms make it hard to design appropriately scaled activity areas around the periphery. The basic structure of a residential building does not lend itself to adaptation to such a radically different use.

Level of Rehabilitation The level of rehabilitation undertaken by most human service programs when they rent or buy a new facility is minimal. Programs tend to take space "as is." Yet to operate optimally, most programs need to reconfigure the space and change fittings and finishes to meet their unique requirements. It is common for new commercial tenants

to rehabilitate, a process referred to as "tenant build-out." A family support center, for example, might want to create a generous common area just inside the entrance designed to be welcoming, a place where parents would feel comfortable lingering. It might be designed like a playground in a public park, with play equipment and toys for children and park benches for adults. Or perhaps it might look more like an oversized living room. One of the most costly yet desirable adaptations a child care program might make is to create bathrooms immediately adjacent to each classroom.

The shortcomings of most facilities can be attributed to the cost-driven process of selecting only among buildings that are available at low cost or no cost; this process yields facilities that are inherently less desirable and dictates that the provider will use it substantially as-is.

The Programmatic Impact of Facilities

The quality of a facility cannot make a poor program good, but it can greatly enhance the quality of any center or even a family day care home striving to implement a strong, "developmentally appropriate" program. Facility quality impacts parents, staff, and children.

Parents Research suggests that unstable child care arrangements, the stress arising from the demanding logistics of drop-off and pick-up, and dissatisfaction with other aspects of their child care arrangements decrease the likelihood that the parent will secure and hold a job. Capital for facilities addresses these problems in several important ways.

1. First, child care supply, especially center-based supply, is relatively scarce in low-income communities. To the extent that the availability and cost of capital is a factor constraining supply, a loan fund can play a role in expanding supply.
2. Second, the capital enables providers to renovate space so that it functions better as child care space, thus resulting in a better program.
3. Finally, parents feel better about leaving their children in a nice, well-equipped, and well-maintained facility. While these characteristics may not alone be a good indicator of program quality, parents feel that their children deserve to be in a nice environment.

Staff There are numerous and profound ways in which facilities affect staff. "Burn-out" is a well-documented problem for poorly compensated front-line human service workers, contributing to high staff turnover. This undermines stable attachment for the children and leaves the industry with too few experienced teachers.

An important factor in this turnover is the greater physical and emotional demands placed on staff working in low-quality facilities. For example, sometimes child care and Head Start teachers have to "break down" their classrooms each Friday and set them up again the following Monday to accommodate weekend Sunday school classes. An almost universal

complaint among child care teachers is the grossly inadequate supply of classroom storage space and running water. Both require frequent trips in and out of the classroom for set-up and clean-up activities. These are just some of the tasks that require extra physical labor, either because the program cannot afford exclusive use of the space or because the facility has never been reconfigured to make the job of teaching easier.

Even more demanding is the classroom management burden created by bathrooms located outside of the classroom area. Bathrooms should be adjacent and directly accessible to the classroom.

Children Youngsters who participate in high-quality programs benefit intellectually, physically, and emotionally. Most child care classrooms are divided into activity areas: dramatic play space, blocks, quiet reading area, etc. To achieve the optimal arrangement, the space needs to be big enough, well proportioned (not too long and narrow, for example), and set up to provide visual separation between activity areas. Scaling bathroom fixtures, window placement, and other features to a child's size helps to foster a sense of competence. But, by far, the greatest benefit to children arises from parents and staff feeling greater satisfaction with the facility and program.

Family resource programs are a newer phenomenon, so it is harder to document the impact of inadequate facilities. Yet central to the principles of the family support movement is a consumer-centered approach to service delivery. Location is obviously key. The space needs to be inviting and be designed to accommodate both parents and children, spanning many age groups. Meeting rooms and office space designed to support access to a blend of services and the wide variety of users are essential. Just like child care, these requirements are impossible to satisfy without a budget that can support the cost of real estate and access to enough capital to reconfigure the space to meet programmatic requirements.

The Two-Dimensional Problem

Capital expenses are fundamentally different from most other program expenses. Unlike pencils, food for snacks, utilities bills, and staff salaries, capital expenditures are made infrequently and have a ***useful life*** that spans years or even decades. In the normal course of things, no enterprise would borrow money to pay for services and supplies that are used within weeks. But debt is the ideal method for making capital investments; a loan spreads the cost over the investment's useful life. In effect, with each year's monthly loan payments, the borrower is only paying for that proportion of the investment being used to deliver that year's services.

From an economic perspective, the problem facing providers has two dimensions:

Inadequate Operating Income Few programs have the operating support in the forms of contract, voucher, fee, and grant income to address all of their operating needs. Rarely does the expanded or improved quality of facilities contribute enough new revenue to offset the burden of

debt-service payments. So the norm among community-based agencies is to pay for capital improvements with grants or to forego them.

Lack of Access to Debt Capital The irony is that some agencies can afford the cost of a loan and are willing to borrow, yet cannot find a bank willing to make the loan on reasonable terms, if at all.

Facilities loan funds are designed to directly address the second dimension of the problem by creating a lender with the financial and institutional ability to make these loans. However, this Guide also maintains that facilities loan funds often stimulate broader systemic changes that affect operating income and the willingness of providers to assume debt, leverage new sources of capital and in other ways stimulate higher levels of capital investments in community-based child and family support facilities. These are the indirect benefits of a specialized facilities loan program.

How do Providers Use Loans?

So if child care centers are so financially marginal, how can they use debt? The answer is that debt is used to fill critical gaps. Here are three examples of loans made by the Child Care Capital Investment Fund in Massachusetts, although the names and some of the identifying details have been changed:

Sunshine Day Care – A well-established program serving 84 children in less-than-ideal donated space for many years was forced to move. After a long search with significant technical assistance from the loan fund's staff, Sunshine identified a vacant city-owned building. It raised most of the $890,000 needed in public and private grants to rehabilitate the space, but needed $120,000 to close the remaining gap. With ***debt service*** of $20,000 a year, the expense represented 3% of the program's revenue: an amount it and CCCIF felt that it could manage. Sunshine had previously borrowed $5,000 from CCCIF to buy a computer and child care center management software as part of a special package marketed by the lender.

Rochester Children's Learning Center – A small child care program in a community north of Boston was able to secure new rent-free space that would lead to greatly improved space and a 30% increase in enrollment. But to fit out the new space, it needed $30,000 for new equipment, money it did not have. Despite an exceedingly tight budget, CCCIF and the borrower were able to get comfortable with the group's ability to service the debt. Like Sunshine, Rochester had previously borrowed money from CCCIF for the computer and software package.

Neighborhood Preschool, Inc. – This child care program qualified for a commercial loan for approximately one-third of the cost of leasehold improvements to a new and expanded center. CCCIF was enlisted to make a ***subordinated*** loan: a high-risk loan to help the center close the gap between the capital grants they received and the maximum loan that the bank was prepared to extend. CCCIF made a $120,000 loan and provided extensive technical assistance, especially around financial management and space design concerns. The loan enabled the center to move to

a larger and more conveniently located site and to expand its enrollment by 72 percent.

See Appendix D for fuller descriptions of two other projects.

The following section begins by describing how facilities loan funds directly improve access to credit. Then it explores the mechanisms through which they can have broader indirect impact on the level of capital investment in community programs.

What is a Facilities Loan Fund?

As described in the previous section, part of the facilities crisis in community-based family and child services is caused by the lack of capital to invest in physical improvements and capital purchases. These programs are often unable to satisfy conventional bank underwriting criteria. Facilities funds are banking institutions, too; they make loans. But unlike conventional banking institutions that line Main Street or occupy the most prominent skyscrapers in every big city, facilities funds are specialized nonprofit lending institutions. They are one of a broader class of lenders known as "development lenders" or ***CDFIs*** that are designed and capitalized to enable them to make some types of loans that commercial lenders find unattractive. The loans might be too small to be profitable. The borrower or project might be too risky for a variety of reasons. There may be insufficient ***collateral*** to ***secure*** the loan. The borrower may be unable to make a sufficiently large down payment. Perhaps there simply is not enough revenue to pay commercial rates of interest.

Most nonprofit development lenders are neither regulated nor capitalized like conventional lenders. As depository institutions, banks are strictly regulated by either state or federal agencies to protect depositors and the public's confidence in the soundness of the banking system. Moreover, as profit-making business ventures, commercial lenders are profit maximizers; they seek to minimize the risk of incurring losses and to secure the most competitive return. For such institutions, some potential borrowers are unattractive.

Access to Debt

Many community-based organizations cannot qualify for bank loans. Facilities funds provide access to credit (loan capital) for those organizations that for one of a variety of reasons cannot qualify for a bank loan:

- **Transaction Costs** The loan might be too costly for a bank to make because of the small size of the loan or the cost to the bank of learning about an unfamiliar type of business.
- **Risk** A bank may determine that the borrower is too financially marginal or is unable to offer acceptable collateral to secure the loan.

An ability and motivation to shoulder these "transaction costs" and "lending risks" are the chief reasons why facilities funds can provide access to debt that conventional banking institutions might avoid.

Pressures do exist to open bank lending to borrowers that are sometimes denied credit. The ***Community Reinvestment Act*** has succeeded in getting banks to look more closely at potential loans they might once have rejected out of hand. The Small Business Administration and the U.S.

Department of Agriculture offer loan guarantees and other enhancements to certain types of borrowers to reduce a bank's exposure enough to meet the institution's underwriting standards. But in the final analysis, safety and soundness requirements dictate that conventional lenders reject many socially worthwhile ventures because they cannot meet their or their regulators' credit standards.

Where do these rejected borrowers go? In most cases, these borrowers forego whatever investment they had sought to make. Certainly, many of those borrowers were well served by the denial; the proposed project may indeed have been too likely to fail. Under these circumstances, individuals and for-profit businesses might borrow from friends, family, or very high-cost lenders. For nonprofit organizations, there is a growing number of nonprofit development lenders that extend credit to otherwise "unbankable" human service organizations. These development lenders include:

- ***community development banks and credit unions*** like Self-Help, a statewide organization in North Carolina;
- national ***community development intermediaries,*** such as the Local Initiatives Support Collaborative, the Enterprise Foundation, and the federally sponsored Neighborhood Reinvestment Corporation;
- ***community development loan funds***, such as Cascadia in the state of Washington and the Delaware Valley Reinvestment Corporation serving Philadelphia and surrounding areas in Pennsylvania and New Jersey; and
- ***facility loan funds,*** such as the Illinois Facilities Fund and the New York City-based Nonprofit Facilities Fund, and their more specialized cousins, such as the Cultural Facilities Fund and Massachusetts' Child Care Capital Investment Fund.

Development economist Albert O. Hirschman has observed that development institutions fall into two categories: demand-following and supply-leading. A demand-following development lender provides capital in a market where demand is strong. For example, emergency loan funds exist in some locales to make short-term working capital loans to nonprofit human service agencies that face periods of temporary lagging cash-flow between fiscal years on state contracts. These nonprofits seek and need these short-term loans to survive, but they may not be conventionally bankable because of lack of consistent profitability, inability to secure personal guarantees, or loan size. But a development lender familiar with state human services contracting may find this an attractive opportunity. If there is sufficient demand for these loans, then by entering this market, the lender is exhibiting demand-following behavior.

Supply-leading behavior is usually the result of miscalculation. In this case, the lender observes that there is a need for debt, creates a loan product, and then discovers that access to capital is only one of the problems preventing investment activity. Fortunately, the existence of loan capital creates the conditions where the other barriers get addressed, eventually leading to investments, although often not without problems. Hirschman sees the tendency to underestimate the obstacles to development as a benevolent process and coined the term *the hiding hand* to describe it. According to Hirshman,

> since we necessarily underestimate our creativity, it is desirable that we underestimate to a roughly similar extent the difficulties of the tasks we

> face so as to be tricked by these two offsetting underestimates into undertaking tasks that we can, but otherwise would not dare, tackle.

The work of the hiding hand can be seen in the experience of many development finance institutions and products. It was certainly the case with Massachusetts Child Care Capital Investment Fund's creation. The loan fund's sponsors realized that the philanthropic sector could not satisfy the demand for capital grants from expanding child care agencies. They felt that debt ought to be a viable alternative. The Fund's board and staff quickly learned that there is a significant difference between the *need* for capital and the *demand* for loans. To the profound unease of the Fund's founders and managers, loan demand lagged far behind projections. Money raised with dramatic documentation of the need sat in the bank while the Fund scrambled to understand the barriers and develop responses that would stimulate demand.

The barriers to lending were many and formidable, including the economics of child care, a culture prevalent in the industry that was averse to both loans and making capital investments, and the limited capacity of child care providers to plan and execute capital improvement projects. As Hirschman's hiding hand postulates, if these problems were known, neither the Fund nor its eventual success would have been possible. Some of the barriers could not be overcome. But some could. After eight years, loan demand exhausted the original capital, enabling the Fund to raise and borrow additional capital. There are indications that the culture has begun to change, albeit gradually. More dramatic has been the effect of technical assistance. As providers confronted inevitable crises— a fire marshal's order to relocate, a state license revocation threat, or an expired lease— providers gradually began working with and increasingly relying on the Fund to help them plan and finance facilities improvement projects.

Subsidizing Loans

If a community-based child or family services program needs to make capital improvements but lacks the ability to pay annual principal and interest payments within its tight budget, a loan is simply unaffordable. End of story? Not necessarily. Two ways a lender can make a loan more affordable are to find resources with which to decrease the interest rate, or increase the repayment period.

For those community-based organizations operating at or near break-even year in and year out, for whom manipulations of the rate and term still do not make a loan affordable, the lender will need to identify a source of deep subsidy. One way to achieve that is through debt service support: annual grants that help the organization make its loan payments. Just as spreading the cost of a project over time with a loan makes a capital project more affordable to a borrower, spreading the cost of grants over a period of years can benefit some funders. Facilities funds can help design and administer such programs.

Example: Recognizing that many nonprofit child care centers could not afford to repay loans for capital expansion projects, the City of San Francisco not only raised $10 million to capitalize a facilities fund (see box in capitalization strategies), it pledged general funds to subsidize up to 80% of the cost of principal and interest. Thus, for example, instead of paying $20,500 a year in principal and interest on a 7-year 10%, $100,000 loan, the borrower might pay as little as $4,100. That type of deep subsidy, while simultaneously making the cost more affordable by spreading the community organization's cost over 7 years, also subsidizes the principal – the capital – as well as the interest expense.

The Fund's experience is fairly typical of facilities loan funds. So are its services. While these funds make loans, they also provide important technical assistance, and often engage in various systems change activities.

Lending

Facilities funds make loans. Nonprofit human service organizations seldom borrow funds. When they do, however, it is usually for working capital lines of credit or for the purchase of or improvements to a major capital asset such as a building.

Facilities funds specialize in extending credit for the purchase and renovation of facilities. Such loans are used for three purposes:

- to purchase or construct a building,
- to renovate a building, or
- to purchase equipment.

Sometimes a loan can involve all three of these uses.

Land and buildings are typically quite expensive assets with a very long useful life. Buildings and their components, such as the roof and the mechanical systems, do wear out and require additional investments from time to time. But the economic life of a facility is relatively long. Indeed, real estate tends to appreciate in value (although this may not be the case in neighborhoods suffering from disinvestment). Because of its long life and expense, financing real estate generally involves large loans and a long repayment period (known as the loan term), typically 15 to 20 years and sometimes even longer.

Renovation projects can be modest, involving just a few thousand dollars, or substantial, involving a "gut" rehabilitation of the structure. In addition, renovations fall into two categories: those done to buildings owned by the borrower and those done to leased properties. The latter are known as leasehold improvements. In most industries, it is rare for a commercial tenant to lease a space without making some level of investment to customize the space for its specialized needs. These "leasehold improvements" are also referred to as "tenant build-outs" or "tenant fit-outs." In some cases, the landlord will make and finance these improvements as part of the rental agreement. In such cases, the landlord serves as the developer, a role that includes financing the improvements and hiring and supervising the contractor. The costs of those improvements and development services are built into the rent. Bringing the building up to current building codes and most mechanical systems improvements— electrical, plumbing, heating, and ventilation— are generally the landlord's responsibility. Otherwise, the tenant build-out is the tenant's financial responsibility.

Loans for leasehold improvements are generally harder to secure and are available for fewer years than a loan to purchase real estate. With a purchase, the borrower gives the lender a mortgage as security. If the borrower fails to repay the loan, the lender ***forecloses*** and recovers the amount owed to it. The security available on a leasehold improvement loan is unattractive. The landlord may grant the leasee the right to ***assign*** the lease to the lender in the event of foreclosure. However, unless the lease is unusually attractive— a great site or favorable rent— assuming the obligation to pay the rent would strike most lenders as a burden, not loan security. Moreover, the loan term for leasehold improvements cannot exceed the term of the lease, excluding renewal options. So the leasees, even when they secure a loan to make leasehold improvements, are

unable to spread the cost of the improvements over as many years as a purchaser. On the other hand, since they are not actually buying the real estate, their need for capital is also less than a purchaser's.

Renovation loans are often used to reconfigure space by removing non-load-bearing partition walls to create more or differently sized rooms, or built-in units, or make a facility handicapped-accessible. Equipment loans are generally shorter still, perhaps for three years. Computer systems, buses and vans, and outdoor play equipment are just some examples of the assets financed with equipment loans.

Technical Assistance

Although making loans is a lender's most obvious function, development lenders generally do more. Most provide technical assistance. Self-Help's community facilities loan program published an excellent guide to understanding a child care program, *The Business Side of Child Care: A Reference Manual for Child Care Advocates and Lenders* (September 1997). The Nonprofit Facilities Fund of New York produces materials and offers training in facilities management. The Local Initiatives Support Corporation and its affiliate, the Community Investment Collaborative for Kids (CICK), make recoverable grants that enable providers to pay architectural, legal, and consulting fees to the members of the development team who plan the facilities project. The Child Care Capital Investment Fund has made grants to pay for an architect and a child care program consultant to jointly assess a provider's space and make recommendations for how to improve it. The Ohio Community Development Finance Fund trains Head Start grantees in how to plan and finance new facilities.

These are just some of the technical assistance initiatives sponsored by community facilities lenders. Training and information dissemination is one strategy frequently used either to build the capacity of providers to undertake and manage facilities projects, or to stimulate demand indirectly by influencing attitudes about debt and facilities investments. Project-specific technical assistance is a more direct technique for supporting loan demand. Most small and medium-size human service agencies need assistance to undertake a facilities investment project. These organizations lack the staff and board members who can devote months, or in some cases, years to the process of identifying a site, negotiating site control, supervising a design team, overseeing zoning and other site-approval processes, raising the financing, and completing the many other development tasks associated with such a project. The leadership of these organizations is usually unfamiliar with the development process; they need ongoing advice from people with development and finance expertise.

Finally, there are the costs. ***Optioning*** land and paying for architectural and legal services are just a few of the out-of-pocket costs of planning a facilities project. Smaller human service organizations generally lack the net worth to pay for these services. Development lenders address these bottlenecks with staff-provided technical assistance, and grants and loans to pay for third-party expertise. Most of these latter costs are routinely treated as costs of developing the project and are recovered by the lender if and when the project is successfully completed.

These lenders also provide business, management, and child care programming technical assistance. In many cases, lenders help providers to improve their financial bookkeeping and to

better understand their financial conditions. Many of these lenders hire child care experts to assist providers to make better use of their facilities. Sometimes the lender helps with marketing strategies and other business advice.

Technical assistance is a set of complementary services required to translate capital needs into loan demand and into new and improved facilities. Provision of technical assistance services is a factor that dramatically differentiates the nonprofit institutions that dominate the development lending field from conventional lenders.

Systems Change

Many facilities lenders also participate in the longer-term process of altering the underlying conditions that contribute to the facilities crisis in human services. A group of 16 nonprofit facilities lenders formed the National Children's Facilities Network in 1993. (See Appendix G for a list of organizations belonging to the Network, along with contact information.) The Network advocates to remove federal funding and regulatory obstacles to child care and Head Start facilities development, offers advice and testimony concerning proposed legislation, and has formulated other legislative proposals.

Independently, these lenders have worked at the state policy level as well. The Illinois Facilities Fund designed and, with the state, helped implement a revenue bond financing program that led to the development of seven child care and family support centers. The Local Initiatives Support Corporation worked with legislative leaders in Connecticut to draft and enact a more ambitious revenue bonding program. The Development Corporation for Children, until recently a development organization, not a lender, has been tapped to operate a facilities loan program for the state of Minnesota.

These public policy and system change initiatives, while not at the core of what these lenders do, like technical assistance, are part of their larger mission of creating more and better facilities for community-based child and family services.

The Market

Despite the budgetary constraints that prevent so many programs from locating and either constructing or renovating a quality facility, some programs nonetheless have, or manage to assemble, the resources they need. To do so, however, usually requires two types of financial resource: (1) a reliable income stream with which to pay a healthy rent and/or to make monthly principal and interest payments on a loan, and (2) ***equity***— such as a capital grant or retained ***net worth***— with which to make a down-payment or other front-end payments to purchase a building or make improvements. Obviously, the more cash (equity) you have in hand to pay for construction or renovation costs, the less cash you need to borrow. In the nonprofit sector, especially among small and medium-sized organizations, the overwhelming preference is to secure philanthropic and government capital grants to cover purchase and construction costs; there is very little understanding of or comfort with debt as a financial tool to spread capital costs over an asset's useful life. However, relatively few foundations and government agencies make capital grants. It generally takes fundraising sophistication and extraordinary leadership to succeed in raising such funds. Larger and more sophisticated organizations that have developed a

donor base of individuals can sometimes launch a successful capital campaign. But once again, this is not common among community-based child and family service programs.

The one arena where some progress has been made in recent years is Head Start. Faced with mounting evidence that restrictive federal regulations making it difficult to use federal funds to purchase, construct, or renovate facilities had slowed the pace of Head Start expansion, the 1992 Head Start Reauthorization Act sought to solve some of the problems by allowing federal grant funds to be used to make interest payments. As a result, Head Start grantees are increasingly willing and able to assume debt to expand capacity. A small number of grantees have used the new regulatory flexibility to cobble together the resources necessary to create model Head Start centers. For many other Head Start grantees located in tight real estate markets, federal capital and annual operating grants are still insufficient to enable them to overcome the low-cost/no-cost, as-is facilities formula.

The demand side of the community-based child and family services facilities debt market is complicated. For-profit child care is more plentiful in higher income communities and in employer-sponsored child care. Some of these are well-capitalized chains that can raise both debt and equity. Some also are "hosted" by real estate development firms or employers who provide space at subsidized rates. Smaller for-profit child care businesses have a more difficult time borrowing money, although they qualify for Small Business Administration loan programs that are not available to not-for-profit organizations. A number of states, including Maryland and Connecticut, also offer loan guarantees designed to induce conventional lenders to extend credit by reducing their risk.

The nonprofit portion of the market is more prevalent in lower-income communities. Such programs can partially offset low public-sector subsidies with grant revenue from foundations, private donors, and workplace fundraising organizations like United Way. On the other hand, many providers argue that the cost of providing care to at-risk children is higher; they often have higher staff-child ratios, as well as needs to provide other services.

In general, the nonprofit child and family services market can be divided into two categories: smaller, usually single-site programs, and larger multi-site and often multi-service agencies. The latter achieve economies of scale and benefit from more diversified funding sources. While smaller agencies tend to be administratively lean, with the program director forced to wear many hats, larger providers can support more specialized middle managers. Directors of larger programs are also more likely to have management experience, whereas smaller programs are more likely to recruit their directors from the teaching ranks. For the larger providers, these differences translate into a greater interest in making capital investments, greater comfort with the notion of using debt, and greater staff capacity to devote time and energy to the complexities of purchasing and/or rehabilitating a facility.

Another factor that contributes to differences among providers is funding streams. In general, Head Start grantees have more stable and adequate levels of funding than child care programs, which rely on state-subsidized vouchers and parent co-payments. Organizations that deliver entitlement-funded services like early intervention programs—especially those funded through the medical insurance system, such as Medicaid— are compensated more adequately and are therefore more able to make facilities-related investments and to use debt as a tool to do so.

One would expect the same type of market segmentation among family support programs. Larger multi-service organizations are better able to cross-subsidize programs and to access philanthropic dollars to augment public funding streams. Such agencies also have the management depth and professional skills to carry out capital planning and to manage a physical development project. However, the family support movement is still young, with few sources of deep operating subsidies and very little experience with the physical dimension of program planning.

The need for capital among human services providers is quite significant. One study places the capital need among existing child care providers at $2.28 billion, and another $16 billion if the system could expand to serve unserved and underserved populations. But capital needs and effective demands are very different. Loan demand among nonprofit agencies is predictably low, constrained by:

- inadequate revenue streams (reliable and adequate sources of income),
- lack of ***creditworthiness***,
- legal, contractual, or regulatory prohibitions against using grant or contract income to purchase buildings, invest in leasehold improvements, or to pay interest expenses,
- norms within the industry that place a low priority on physical capital investments relative to other programmatic needs,
- inexperience and discomfort with debt as a financial tool,
- thin management staffing within smaller agencies, and
- lack of expertise in developing and financing facilities.

While loan demand is low, so is the supply of debt capital. Banks are the main source of conventional commercial debt. While commercial lending is an important line of business for most banks, the child care market is unattractive to most banking institutions. The child care market generally suffers from:

- high ***transaction costs***,
- ***loan-to-value*** problems in underwriting,
- inadequate collateral,
- weak and inconsistent earning history,
- lack of credit history,
- absence of personal ***guarantors***,
- biases against nonprofit borrowers, and
- concerns about the public relations implications of exercising the bank's foreclosure option in the event of default.

Most of these problems would apply to family support programs as well.

Filling the gap between the modest demand for community-based child and family service facilities loans and the scarcity of available loan capital has created a niche market opportunity for nonprofit development lenders. These organizations have successfully made facilities loans by absorbing the high transaction costs, shouldering greater risk, offering technical assistance, developing specialized knowledge of the industry or sector, raising a pool of capital to

collateralize loans, and adopting alternative ***underwriting*** methodologies. Many of these lenders have also sought to stimulate demand by attracting equity and lower-cost capital, and offering educational programs. Guided by their missions, development lenders often find themselves in the paradoxical situation of having capital but weak demand; their job includes the complicated tasks of removing barriers, solving problems, and stimulating systemic changes that will both create demand and produce important social investments in the community.

Types of Loan Funds

The development lending industry has grown dramatically over the past 20 to 30 years. There are even a few for-profit community development banks, most notably Shore Bank in Chicago. This guide focuses on the nonprofit institutions that have been most active in facilities lending.

Development lenders serving child care and family support programs vary by level of specialization, whether they are regulated depository institutions and their capital structure. These characteristics strongly influence institutional behavior.

Specialization

Broadly speaking, categorizing development lenders by their specialization in family support or child care lending produces three groups:

- Industry-Specific Loan Funds,
- Nonprofit Facilities Funds, and
- Community Development Loan Funds.

The trend in development lending is increasingly toward institutions that serve multiple markets. However, it is extremely difficult to address the credit needs of the child care and family support organizations without creating a dedicated source of capital and specialized staff, because the market for loans is extremely weak. The challenge is to use a supply-leading strategy and technical assistance to develop a market.

One of the keys to success in development lending is a thorough knowledge of markets that appear to be fraught with risk to conventional lenders. That is one reason for industry-specific lending. Many community development lenders started as affordable housing lenders before branching out into micro-business lending, business lending, and other fields. Child care loan funds are a relatively new form of industry-specific lender. The Child Care Capital Investment Fund lends primarily for child care, early intervention, and Head Start centers. The Development Corporation for Children in Minnesota recently launched a loan fund affiliate, First Children's Trust.

A fundamental principle for managing and limiting financial risk is diversification. Specialization concentrates risk, leaving a lender vulnerable to unexpected changes in market conditions that might place the lender's entire loan portfolio at risk. This risk is partially offset by the greater knowledge of a market that comes with specialization. Specialization enables the lender to be better equipped to assess these risks and to craft strategies for mitigating them. For example, Head Start and state-subsidized child care rely on very different income streams. An early

childhood facilities lender can diversify by funding different types of early childhood programs.

In undeveloped markets, such as child care and family resource lending, failure to specialize will almost certainly limit the potential borrowing. For example, during its first few years of operation, the Child Care Capital Investment Fund experienced unexpectedly low loan demand. In response, the Fund briefly considered expanding its market by becoming a nonprofit facilities fund that would serve a much broader array of human service organizations. Since these organizations face facilities financing needs that are similar to those in child care, serving their needs as well would have the effect of expanding the market for the Fund's capital. This option of becoming less specialized was rejected. Had it been adopted, loan demand probably would have increased. However, the market the Fund eventually developed among child care agencies probably would not have materialized, because staff would have pursued the path of least resistance rather than nurturing the child care market. Thus, specialization is essential in the common development lending circumstance where loan demand is weak.

Somewhat less specialized are the nonprofit facilities funds. These lenders address the credit needs of nonprofit human service organizations. Best known of the facilities funds are the Illinois Facilities Fund and the Nonprofit Facilities Fund of New York. Far more common are more diversified community development lenders. The current term of art for such institutions, including the more specialized ones described above, is "***Community Development Finance Institutions***" (CDFI), a term popularized after Congress passed the Community Development Financial Institutions Act in 1994. The community loan funds, community development corporations, and community development credit unions often make an occasional child or family service facilities loan as part of their normal business and commercial lending.

A growing number of CDFIs have created specialized lending programs either targeted to community facilities or child care lending. Coastal Enterprises, for example, a statewide community development corporation in Maine, established a separate child care lending program with its own dedicated capital source, lending staff, and technical assistance providers. Such programs benefit from the economies of scale that larger financial intermediaries can achieve, while retaining the specialization and focus on the unique challenges and needs of a niche market like child care. Similarly, Self-Help, a community development credit union and loan fund serving North Carolina, has operated a child care lending program for a number of years. It recently enlarged that activity into a broader community facilities lending program.

The trend in the industry seems to be to promote specialization, but to do so through corporate structures that allow them to achieve economies of scale. For instance, after its pilot phase, the Child Care Capital Investment Fund merged with a state quasi-public agency, the Community Economic Development Assistance Corporation (CEDAC), as a controlled affiliate with its own board of directors and loan officers, but shared ***loan servicing***. In other cases, the child care or facilities lending is organized as a program or profit center for a more diversified community development lender.

These hybrid structures combine the best of both worlds: specialization that enables them to meet the market development challenges of lending to a particular sector of human service providers, with the multiple advantages of doing so within a corporate entity with the economies of scale, managerial systems, diversification, and lending expertise to ease start-up, minimize costs, and

manage risk.

Regulatory Environment

Most depository institutions are subject to either state or federal regulations. These regulations are designed to assure depositors that their money is safe and the general public that the banking industry is sound. Regulated financial institutions have much less flexibility in the type of loans they can make than unregulated lenders. So, for example, a regulated lender may have to reject a loan request because the borrower cannot provide sufficient collateral, whereas an unregulated lender might feel that the borrower's fundamental creditworthiness mitigates the need for the level of collateral required by regulators. The unregulated lender has the operating flexibility to make such loan judgments. Depository institutions, such as Shore Bank in Chicago, and community development credit unions, such as Self-Help in North Carolina, are regulated. Nonprofit facility loan funds, like Illinois Facilities Fund, and community development loan funds, like Delaware Valley Reinvestment Corporation, are unregulated because they do not accept conventional deposits. Unlike depository institutions, in order to raise their temporary capital, unregulated financial institutions create temporary investment instruments or borrow funds. Although more highly regulated, depository institutions have the advantage of being able to raise far more capital through the depository mechanism.

Capital Structure

Belden Daniels, a development finance consultant, is fond of observing that financial institutions "are what they eat"; in other words, the characteristics of their capital largely dictate lending behavior. For example, a bank with short-term deposits will be limited in its ability to make long-term loans. Similarly, an institution that pays its depositors or investors a high rate of interest must charge its borrowers an even higher rate.

There are three characteristics of a lender's capital structure:

- Length of temporary capital investments,
- Ratio of permanent to temporary capital, and
- Cost of money.

Lenders derive their loan capital from two sources. Temporary capital is, as the name suggests, temporary. A savings deposit is temporary capital. The depositor will eventually withdraw the funds. In effect, these are funds that are loaned to a bank or lending institution. That institution, in turn, pays the depositor interest. Development banking institutions raise temporary capital from depositors as well as from other types of temporary investments, including borrowing funds that they re-lend, usually at a slightly higher interest rate than they pay to their lender.

Permanent capital, on the other hand, is ***net worth***. It is money a bank owns free and clear. Net worth or equity is the banking institution's own savings, its nest-egg. The combination of permanent and temporary capital represents a lender's total "capitalization."

Length of Temporary Capital Investments

The great advantage of loans is that they enable a borrower to spread the cost of an asset over its useful life; you may not have the $12,000 you need to buy a car, but you can afford $300 per month in interest and principal payments on a 3-year auto loan. Since most of the money lent by financial institutions is money they have borrowed from other people and institutions, lenders have to match their assets (the loans they make) and their liabilities (the loans made to them). Remember Jimmy Stewart's predicament in "It's A Wonderful Life": faced with a "run" on the saving and loan association he operated, he implored his neighbors not to withdraw their deposits. As he explained it to his panic-stricken depositors, the little community-based lender did not have the cash available; instead, the money was working in the community, funding home mortgages for others in the town.

That is the predicament of some lenders. If a lender derives its temporary capital from short-term sources such as checking accounts, they are more likely to make short-term loans such as working capital lines of credit and construction loans. But with more long-term investments, like 5-year certificates of deposit, a lender can manage to make longer- term loans.

In trying to fund the purchase or renovation of a building, or even leasehold improvements, family support and child care programs generally need the longest possible loan terms. A $10,000 loan for 5 years at 8% requires $2,500 a year in debt service (principal and interest). But the same loan written for 10 years costs less than $1,500 a year: a 40% savings on annual debt service payments. Admittedly, the total interest paid over the course of the repayment period will be higher with the longer loan. The advantage for the borrower, however, is that the lower annual costs are affordable with the longer ***amortization*** period.

So the length of temporary capital investments in a lending institution influences the length or term of the loans it can make, and therefore also determines the type of lending it does. An institution with short-term temporary capital is more likely to do construction lending, which has loan terms of less than a year and a half, than permanent mortgage lending, which has terms in excess of 10 years. From the perspective of a borrower taking a loan to pay for a capital improvement with a long useful life, borrowing from a lender with long- term temporary capital improves the likelihood of securing a loan with a longer term, which, in turn, will have more affordable monthly payments.

Ratio of Permanent to Temporary Capital

Another related feature of capital structure is the proportion of the lenders, total capital that is "equity" (also known as "net worth," "net assets," or "permanent capital"). These terms refer to the lending institution's own savings. Unlike temporary capital, permanent capital cannot be redeemed (although operating losses will reduce the institution's savings). However, assuming that the lender operates on a break-even basis, the permanent capital is just that: permanent. So, with more permanent capital, a lender has the ability to make longer-term loans.

Permanent capital also has a favorable effect on interest rates. Lenders pay for the use of

temporary capital. This is a cost passed on to borrowers in the form of interest payments. The higher the institutions' cost of money, the higher the interest rate they charge borrowers. But since permanent capital has no cost (other than ***opportunity cost***), a lender with a lot of equity relative to its temporary capital, has a lower cost of money: hence the ability, at least among nonprofit lenders, to make lower-cost loans.

Development loans are believed to entail more risk than conventional loans. If the lenders are responsible for repaying temporary capital, they will likely be more risk-averse with such funds. Though it is an extremely valuable resource, a lender can assume more risk with its permanent capital than with its temporary capital. So, in addition to having lower costs, a lender blessed with a high proportion of permanent capital can shoulder more risk.

Finally, permanent capital is like an endowment. It generates interest income for the lender. Part of this is devoted to fund a loan loss reserve and other operating costs. But the spread (the difference between the cost of money and the amount of interest paid to the lender on money it lends) is obviously much larger on permanent capital; the difference is frequently used to fund technical assistance services that are central to a development lender's mission.

Cost of Money

The use of temporary capital comes at a price to the lender. Banks pay interest to their depositors, and so do community development lenders. The community development lender's temporary capital comes in the form of loans, or "equity equivalent investments." These too bear interest, although in some cases these loans are made by philanthropically oriented individuals and institutions who forego a market rate of return on their funds in order to further the lender's mission. For example, some foundations make "program related investments" (PRIs) in order to enable a development lender to make more loans. The Ford Foundation made PRIs in Coastal Enterprises' child care loan program and in the Child Care Capital Investment Fund. The foundation charged 1% interest, an extremely favorable rate. This made the Fund's cost of money very low. With the approval of the Ford Foundation, the Child Care Capital Investment Fund charged child care providers 5% on its loans. The Fund's 4% markup enabled it to absorb the high transaction cost involved in making these loans and allowed it to provide a great deal of technical assistance to its borrowers. After seven years, the Fund made the first of four annual payments to retire the Ford investment. To replace the capital and expand its lending, it has since negotiated two new loans, one for $1 million, the other for $3 million, with a consortia of banks and with an insurance company. These new loans are also at a favorable interest rate: 5%. But this is five times the cost of the Foundation's PRI and has forced the Fund to raise the rate of interest on its child care facilities loans to 7.5%.

Because it is less costly, permanent capital affects a lender's average cost of funds. A fund with $1 million in permanent capital and a $1 million, 5% investment in temporary capital has an average 2.5% cost of money. If the same institution had $3 million in permanent capital instead of $1 million, its average cost of money would be half as much, 1.25%. However, such proportions are hard to achieve in the real world.

Facilities funds with the high cost of money not only must charge higher interest rates, they are under pressure to minimize operating costs. Such a fund would be forced to pursue higher-quality, less risky credits and would be less likely to provide technical assistance. Thus, capital structure is a critical consideration in designing a development finance institution. The capitalization must follow from the needs in the market.

In general, development lenders that are capitalized with a high proportion of equity, pay substantially below-market rates for their temporary capital, have long-term sources of temporary capital, and are unregulated have greater flexibility to offer products and services tailored to the needs of young and undeveloped markets for debt. On the other hand, the regulated financial institutions tend to be larger and realize significant economies of scale. These institutions are better positioned to do the type of volume lending that is possible where loan demand is high.

Lending Policies

As the earlier discussion about capital structure suggests, loan products and lending policies are influenced by the characteristics of the fund's loan capital. They are also a function of the lending institution's mission. Key policies and loan product characteristics include:

- Eligible Borrowers
- Location
- Users
- Auspices
- Management and governance characteristics
- Finances
- Programmatic Characteristics
- Eligible Projects
- Loan Product
- Loan Term
- Rate
- Loan Size
- Loan Structure
- Collateral

Eligible Borrowers

Any lending program designed to serve community-based child and family service agencies is, by definition, a specialized, and probably a nonprofit, development lender. In pursuit of its mission, it will target its lending by limiting the type of borrowers and projects that are eligible to receive loans. Most nonprofit development lenders limit eligibility geographically. For example, loans may only be made in a specific city, county, or state. Many further restrict eligibility based on a jurisdiction's socio-economic characteristics, such as median family income.

Another way to achieve targeting is by the program's users, rather than by its location. One fund requires that no less than 30% of the children being served in the borrower's facility be

low-income. However, the portfolio average must be 70% low-income children. Thus, most of its borrowers are programs serving a population that is more than 70% low-income.

Some programs lend to both nonprofit and for-profit entities. Others limit their lending to nonprofit organizations. Although the child care market is dominated by nonprofit entities, there are often small proprietary centers and even family day care providers who need access to capital and serve a low-income or at-risk population. In some states, child care delivered by religious organizations is exempt from state licensing requirements, on the theory that such regulations would infringe on religious freedom. Driven by a desire to raise the quality and standards, some lenders restrict their lending to licensed programs.

Some lenders have policies that promote loans to minority-managed programs or those whose boards of directors meet certain standards for diversity. These borrower characteristics relate either to the lender's mission or to funder-imposed mandates and have the effect of targeting the fund's limited resources to address specific needs. These policies also affect the size of the lender's market by increasing or decreasing the number of eligible borrowers and thereby affect loan demand; the larger the market, the greater the number of loan requests a lender can expect to see. On the other hand, the larger number of loans requests may be offset by a lower proportion of requests from borrowers that reflect the lender's social objectives.

Financial health is a consideration for all lenders. The basic principle of loan underwriting (the term used to describe the lender's analysis of the soundness of a financing request) determines a borrower's ability to make all the required principal and interest payments on a timely basis. In addition to looking at financial projections to show how these payments will be made, borrowers have to present at least three years' worth of financial statements. Among the factors lenders evaluate are the borrower's ability to operate at or above a break-even level, other outstanding indebtedness, net worth, and liquidity.

Profitability - If an organization runs a deficit for more than one year without a very good explanation, most lenders would be suspicious of the borrower's financial health or financial management.

Indebtedness is important for a variety of reasons. Among other things, a potential lender wants to know if the borrower has a track record of meeting its obligations to its lenders. They also want to be sure that the agency is not assuming more debt than it can afford.

Net worth is the net cumulative surpluses the borrower has earned over its life. Annual operating surpluses add to net worth; deficits reduce it. An organization with a negative net worth owes more money than it has, and would presumably not qualify for a loan even from the most lenient lender. Many lenders want a borrower's net worth to be some stipulated proportion of the operating budget, because it is an essential source of working capital and because net worth provides a margin of safety, enabling the borrower to weather unexpected adversity and occasional operating losses.

Liquidity refers to the borrower's supply of cash to meet its current financial obligations. Lenders usually expect current assets to exceed current liabilities by at least 20% and in some cases considerably more. Such relationships tell a lender that the borrower has enough cash to pay its bills on a timely basis.

This type of analysis of the borrower's finances comprises much of the underwriting employed by both development and conventional lenders. Each captures a different aspect of financial well-being.

Programmatic Characteristics

Many development lending program incorporate into their loan underwriting social objectives, some of which may be required by funders. Such objectives may include serving underserved groups such as infants, toddlers, and special needs children, or encouraging co-location or strategic partnerships with other human service providers serving the same families. For example, the City and County of San Francisco's Child Care Center Development Loan Program gives priority, especially in the awarding of debt service support, to programs that serve:

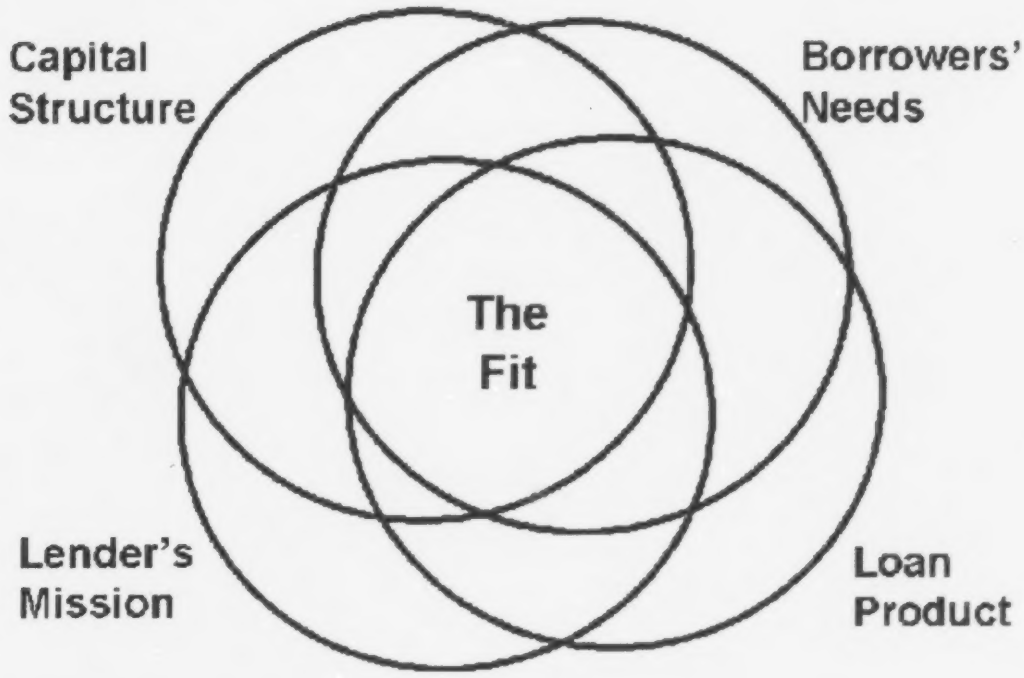
1. Families transitioning from welfare to work;
2. Children with special health needs;
3. Infants and toddlers;
4. Families needing after hours, sick, or drop-in care; and
5. Children and families needing other human services provided through established linkages.

Programmatic characteristics may sometimes be used as an absolute eligibility standard. In many other cases, however, they are used to provide a relative preference in the awarding of loans, more favorable loan terms, or grants and subsidies.

Eligible Projects

All lenders limit the uses to which a borrower can apply the proceeds of a loan. In most cases, facilities lenders do not offer revolving credit lines to meet borrowers' needs for working capital. The underwriting for such business loans is very different from capital loans for facilities and equipment.

Lenders may further limit eligible projects to energy conservation loans or rehabilitation loans, for example. Obviously, such restrictions ought to reflect some effort on the lender's part to align its lending with a need, its mission, its capital structure, and an appropriately designed loan product. This "fit" is depicted in the following diagram:



Loan Product

Like a suit of clothes, loans have to be carefully fitted and tailored to meet the needs of a given situation. The features of a loan that can be altered are rate, term, amount, and structure. The first three are relatively familiar. The fourth is more complex. Lenders establish policies regarding all four characteristics. Together, these attributes largely define a loan product.

Interest Rate Development lenders generally set the interest rate they charge on loans to cover the cost of their money-- the amount paid to their investors-- plus some mark-up to reflect the lender's own costs of ***originating*** *and* ***servicing*** its loans. The interest rate is the "price" borrowers generally use to gauge the cost of the loan. Obviously, a lower interest rate is less costly to a borrower and presumably makes a loan more attractive as well as more affordable. All things being equal, a development lender would like to keep the rate low. Indeed, some development lenders believe a relatively low rate is essential to make loans acceptable to relatively unsophisticated nonprofit borrowers.

Term The length of a loan, or "term," is perhaps the most important characteristic of many development loans. As the term is extended, monthly payments go down, making the loan more affordable. Compare the effect of term and rate on the monthly principal and interest payment on a $10,000 loan.

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Impact of Rate and Term on Monthly Loan Payments

		Loan Term in Years					
		5	10	15	20	25	30
Rate	5%	$189	$106	$79	$66	$58	$54
	6%	$193	$111	$84	$72	$64	$60
	7%	$198	$116	$90	$78	$71	$67
	8%	$203	$121	$96	$84	$77	$73
	9%	$208	$127	$101	$90	$84	$80
	10%	$212	$132	$107	$97	$91	$88
	11%	$217	$138	$114	$103	$98	$95
	12%	$222	$143	$120	$110	$105	$103
	13%	$228	$149	$127	$117	$113	$111
	14%	$233	$155	$133	$124	$120	$118
	15%	$238	$161	$140	$132	$128	$126

Although lenders should not extend the term of a loan beyond the ***useful life*** of the asset it finances, extending the loan as far as possible has a more profound impact on loan affordability--monthly payment-- than modest reductions in the interest rate. Halving the rate from 10% to 5% on a 5-year loan saves $23 per month. But doubling the term from 5 to 10 years saves $80 per month. Since most organizations cannot afford to make large investments up front with cash on hand, the key to capital financing is to spread the cost of the asset over its entire useful life. Borrowing, in short, is a tool for spreading capital costs in order to make them affordable.

Loan Size

Most lenders have policies relating to loan size. First, they limit the size of individual loans in order to avoid concentrating too much of their capital in a single project or borrower. If either failed, the lender could sustain a ruinous loss. So portfolio risk management dictates some limit that is generally a function of total capital. Thus, a policy might be no loan can exceed 10% of the lender's total capital.

Policies also generally limit loan size relative to the total value of the asset being financed. The most typical measure used to limit the size of the loan is the "**loan-to-value ratio**." For example, a lender may lend no more than 80% of the value of the asset. An addition to a building appraised at $100,000 might only qualify for an $80,000 loan; the borrower would need to come up with $20,000 in cash before the lender would close the loan. Loan-to-value protects a secured lender by creating a margin of safety in the event of foreclosure; if the asset does not sell for as much as the appraised value, the lenders can feel reasonably confident that they will at least recover the principal value of the loan and thereby avoid any loss. Moreover, many lenders, especially conventional lenders, like borrowers to be at risk of losing their own money, so that they do not "walk away" from their financial problems. Borrowers with a financial stake, lenders reason, will be more likely to do whatever is necessary to remain current on their loan in order to avoid foreclosure.

In child care lending, loan-to-value calculations can be problematic. Once it has been renovated to serve as a child care center, a building is highly specialized. There would be relatively little market demand for the space in its new condition, because few child care businesses are either in the real estate market looking for space or have the financial resources to pay the premium

associated with purchasing an improved facility. Compounding the loan-to-value problem is the high cost of a well-designed child care facility. Consequently, a real estate appraiser, determining there will be little demand, will place a value on the property far below the cost of building the center. Hence, an 80% loan may only cover 40 or 50% of the cost of the facility. In many cases, this will not be enough to enable the child care program to proceed with the project.

For this reason, some child care lenders assume more risk by lending far more than they could recover at foreclosure. However, these lenders would never lend more than the cost of the project, and they can be expected to carefully scrutinize costs to ensure that they are reasonable. This is one dramatic example of how some development lenders are different from conventional banks.

Loan Structure

There are a number of other variables that a lender can manipulate to alter the shape of a loan product besides loan term, rate, and amount. A lender can charge interest only for some period before requiring the loan to amortize through monthly principal and interest payments. A start-up program that will not have sufficient revenue to service the loan for some period while enrollments build may be permitted to pay the lower cost of interest only initially.

A lender with a maximum loan term of 10 years might offer a borrower a 10-year loan with a 20-year amortization schedule. At the end of the 10 years, the lender may assume either that new capital will enable it to roll the loan over for the remaining 10 years or that some other lender will be willing to write a loan for the balance because the loan is "seasoned" and the outstanding principal balance will have been significantly reduced. In this way, a lender with a capital structure that limits loan terms can create a product with somewhat more risk to the lender but that meets the borrower's need for longer term debt.

To get a better idea of the kind of information lenders use in reviewing loan applications, refer to Appendix E, which contains the application form used by the Child Care Capital Investment Fund. Appendix F contains an example of loan guidelines, in this case guidelines for San Francisco's Child Care Center Development Loan Program.

Collateral

The loan underwriting process is an exercise designed to minimize the risk that a borrower might ***default*** on the loan. The very best way to minimize risk is for a lender to have one or more fallback strategies that will prevent a loss in the event that the original repayment assumptions prove faulty. Say a borrower provides compelling evidence that a set of state contracts that has sustained a family support program is stable and very likely to continue well into the future and that it generates enough revenue to service a loan. If an unexpected fiscal crisis forces the state to reduce contracts, the primary repayment source might evaporate. Lenders generally structure a secondary and tertiary fallback. Often these fallback repayment strategies involve some form of "secured" interest. A secured interest is a legal right to an asset, a mortgage for example. A mortgage gives the lender the legal right to sell a mortgaged property to satisfy a loan. A borrower might pledge other assets instead or in addition to the real estate. If the agency has an endowment, the borrower might be required to secure the loan with it. It is the policy of some lenders to be fully collateralized. Some development lenders may only seek partial

collateralization or forego a security interest altogether. However, most development lenders will seek a security interest if an asset is available, even if its value is inadequate.

Start-Up Strategies

Launching a facilities loan program is a challenging undertaking, but there are strategies for making the entire project quite manageable. Starting a loan program requires a great deal of planning. There must be clarity about the following: what are its sponsors attempting to achieve through the provision of loans? Are these goals achievable? What kind of financing will be needed, and what will loan demand be? Where will the loan capital come from? Who will actually staff the enterprise? To raise capital, the sponsors will be required to prepare a business plan, including a set of detailed financial projections like those contained in Appendix B. Loan documents will need to be drafted and mechanisms put in place to service the loans.

The task of starting a facilities loan fund or a more specialized child or family services loan program is made easier if an existing lender is involved in the planning. When the City of San Francisco and the Miriam and Peter Haas Fund decided to launch a child care loan program, it turned to a well-established development lender in the city, the Low Income Housing Fund (LIHF). That agency in turn researched the experience of other development lenders around the country that had already entered this market. It also hired the Illinois Facilities Fund, a Chicago-based nonprofit facilities lender with child care lending experience, to assist it to become familiar with the child care industry.

The funding collaborative led by the United Way of Massachusetts Bay adopted a similar strategy when it decided to establish a subsidiary to make loans to nonprofit child-serving agencies providing services to low-income families. It issued a request for proposals for a management team, eventually hiring a team comprised of three established nonprofit organizations: a nonprofit management assistance organization, a quasi-public development lender specializing in affordable housing, and a child care resource and referral agency. The key competencies required to successfully do sector-specific facilities lending are development lending capacity and familiarity with the child care or family support "industries."

Lending Capacity

The lending capacity necessary to operate a child and family services loan program is somewhat different from those of conventional lenders. One funder crafted financial projections for a proposed loan fund with the assistance of a conventional lender. Key variables, such as the lender's cost per loan, were based on the lending experience of large commercial lenders that make thousands of large loans to financially strong for-profit businesses. But child care lending involves a low volume of small loans to financially weaker borrowers with little prior borrowing experience. Many community development lenders have development lending experience, even if they are unfamiliar with human service organizations.

Affordable housing, a specialized brand of real estate lending, is the core lending business for many development lenders. While facilities lending involves real estate, the underwriting, which depends on revenue generated by the child care or family support program, is really business lending.

The other dimension of lending capacity is the systems for underwriting, originating, and servicing loans. Creating loan documents, bookkeeping, and other systems is expensive, especially when done for a loan portfolio of less than $5 million. Existing lenders will have already created these systems. Even if loan documents need to be amended, the infrastructure exists to manage the lending business.

Industry Expertise

The other expertise that is critical to the success of funds created to serve community-based child and family services organizations is industry-specific knowledge about the business and the funding streams that support it. This knowledge is invaluable in marketing loans, underwriting loans, delivering technical assistance, and designing loan products. It is interesting to observe that even existing development lenders often establish special programs or funds to handle child care lending. Maine's Coastal Enterprises, North Carolina's Self-Help, New Hampshire's Community Loan Fund, and San Francisco's Low Income Housing Fund each created child care lending programs with dedicated staff, separate capitalization, and distinctive identities when they chose to begin lending to child care borrowers.

The same principle of sectoral expertise would apply to family support lending programs if and when lending programs emerge to support them. To date, this is such a small market that no funds have been specifically created to finance family support programs, although nonprofit facilities funds, like the Illinois Facilities Fund and the Nonprofit Facilities Fund in New York, do service this market. Unlike community development lenders that primarily finance affordable housing, facilities funds focus on human service, health and education agencies, and, to a lesser extent, community-based arts and cultural organizations. Child and family service programs belong to that market and have a great deal in common with many of the other human service agencies that borrow from them.

The experience in the field suggests that those wishing to strengthen child and family services by making debt capital available would be well advised to do so in partnership with an existing development lender and to build-in sectoral or industry-specific expertise, rather than launching a lending program from scratch.

Capitalizing A Loan Fund

To make loans, a lender needs capital. The section above about capital structure addresses many of the key issues. To make facilities loans, a lender needs to be able to offer long- term loans. And to serve community-based family and child service organizations, the lender will need to be able to provide technical assistance, be able to lend at least partially unsecured, and shoulder high levels of risk. This profile requires a relatively high proportion of permanent capital and low-cost, long-term temporary capital. Where does a lender raise this kind of capital?

North Carolina's Capitalization Strategy: Using Child Care Development Block Grant Funds to Leverage Debt Capital

Working with the state of North Carolina, Self-Help's Community Facilities Fund has engineered a creative way to

use federal Child Care Development Block Grant (CCDBG) funds to leverage debt capital for child care programs. As with any pioneering effort, it took a lot of time and energy to design a structure that satisfied all the statutory and regulatory requirements of the CCDBG program and the needs of lenders, investors, and borrowers.

Self-Help began the process in 1991. While block grant funds began to flow to Self-Help by 1992, the first loan was not made until 1994. According to Laura Benedict, the Director of the Community Facilities Fund, it took another year before the process enabled lending to achieve a significant volume of 30 loans per year.

To date, North Carolina has invested $1.5 million in Self-Help through a contractual relationship that is renewed every two years. The funds are held by Self-Help on deposit in its credit union and are used by the Community Facilities Fund to collateralize its loans to eligible child care borrowers. Because the loans are secured in this way, Self-Help's assets are available to actually fund these child care loans. Thus, CCDBG funds leverage Self-Help's private-sector capital and enable the Community Facilities Fund to make loans that would otherwise be too risky to write. (See the illustration on the following page.)

These funds can be used as collateral for loans made to a child care center or family day care home that will be licensed or registered at the time the loan closes and agrees to serve children who receive subsidized care. To deny access to well-capitalized corporate chains, for-profit borrowers cannot operate more than three centers. The effect of these guidelines is to bring borrowers under state regulation and to increase the quality and supply of child care for low-income families.

Although the state has not restricted the size of CFF loans, the contract requires that the Fund secure prior permission to use more than $50,000 of state funds in a loan. The state is considering a request to increase that ceiling in order to reduce the number of waiver requests. Other restrictions placed by the federal government on the use of CCDBG funds include the prohibition against using the funds for major renovations or construction that might add significantly to the value of the property, for land purchases, or for new structures. Minor renovations that do not add to the square footage of the building are eligible. So are loans for working capital, equipment, playground structures, vehicle purchases, and closing costs.

These restrictions apply to the portion of a loan backed by state-supplied CCDBG funds. However, since the state's collateral leverages additional borrowing, Self-Help has managed to create some flexibility in its lending without violating restrictive CCDBG regulations. For example, a $100,000 construction loan might involve $30,000 in CCDBG-eligible costs. By securing the first $30,000 in loan losses incurred on the $100,000 loan with an assignment of the state's block grants held by Self-Help, the Fund's greatest financial exposure in the transaction is secured by the equivalent of a certificate of deposit. Rarely does a default result in a complete write-off: The lender can usually sell some of the borrower's assets to reduce the size of the loan loss. Between the security for the loan provided by the borrower and the relatively small state guarantee, Self-Help has largely removed the lending risk. On the other hand, this means that the CCDBG funds usually leverage about three and a half times the amount of the state's financial exposure.

Although its contract with the state must be renewed every two years, any money pledged as security against an outstanding loan stays with Self-Help until the loan is repaid. Since some loans will not be repaid for 20 years, some CCDBG funds will remain on deposit with Self-Help for that long, even if the contract is terminated. To date, Self-Help has written off $8,000 or 1% of the CCDBG funds earmarked to guarantee Self-Help's child care lending. The state's guarantee has enabled the Fund to relax its underwriting and absorb greater risk. While this produces slightly more loan losses, it also produces more loans, most of which succeed and would not otherwise have been made.

The final benefit of the state's deposit is the subsidy it creates. The state foregoes interest on the funds deposited with Self-Help, creating about $75,000 in income, assuming 5% interest. That income helps cover the extraordinary transaction and technical assistance costs associated with these loans and helps subsidize the interest rate to the borrower.

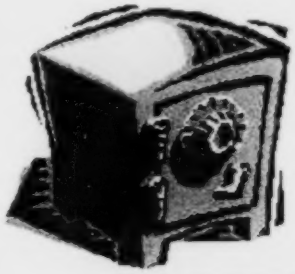
This arrangement has enabled Self-Help to write 80 loans worth approximately $2.8 million backed by $800,000 in state funds.

An Example: How North Carolina uses CCDBG funds to leverage loans

1. State makes a $1.5-million interest-free deposit of CCDBG funds in Self-Help to help offset potential loan losses.

$1.5-Million Deposit

State of North Carolina



2. Self-Help sets aside $30,000 to guarantee the first $30,000 in potential losses on a $100,000 loan. This substantially reduces its lending risk.

Up to $30,000 in loan reimbursed to Self-Help

Loan payments to Self-Help

3. With the security of the state's guarantee, Self-Help feels comfortable lending a child care provider $100,000 of its depositors' money.

Self-Help

$100,000 loan

...disbursed to provider

North Carolina's $1.5-million deposit is enough to guarantee 50 loans of this size.

Most existing funds benefit from an initial investment of pure equity in the form of foundation and corporate grants. An important new source of equity for development lenders is the U.S. Department of Treasury's Community Development Finance Institutions Fund, created by the

Community Development Banking and Financial Institutions Act of 1994. (See Appendix C for more information about the CDFI Fund.) Permanent capital or equity is important because it is like an endowment: the lender incurs no cost for using these funds, as it would with borrowed funds. These funds can be lent long-term, and the lender can assume somewhat more risk than it can when lending borrowed funds.

LISC's Rural Capitalization Strategy: Blending Federal Grants and Loans with Private Sources

In 1997, the Community Investment Collaborative for Kids (CICK), a program of the Local Initiatives Support Corporation (LISC), convened the *Rural Collaborative*, an innovative partnership with the Head Start Bureau of the U.S. Department of Health and Human Services (HHS), the Community Facilities Program of the U.S. Department of Agriculture's Rural Housing Services (RHS), the Federal Housing Finance Board and Federal Home Loan Bank System, and the National Head Start Association (NHSA), created to facilitate the development of early childhood centers in rural communities around the country.

The *Rural Collaborative* is significant because it is the very first time these federal agencies have worked together to systematically address the growing shortage of high-quality Head Start and child care facilities. Recognizing the challenging economics of early childhood programs in low-income communities and the limited finance and real estate development experience of child care program managers, the national partners provided a creative mix of financing and technical support to community-based organizations in six states.

The essential elements of the *Rural Collaborative* are:

- Technical assistance on facility design, development, and financing from LISC and NHSA;
- Private up-front seed funds for project planning from LISC (through support from the Freddie Mac Foundation and other sources);
- Low-cost, long-term loans made by the RHS Community Facilities Program;
- Equity grants from the Head Start Bureau;
- Private bank loans made with the benefit of RHS loan guarantees; and
- State and local matching funds, primarily Community Development Block Grant funds awarded by the locality.

Most nonprofit child care and Head Start providers in lower-income communities rely heavily on public operating subsidies, and cannot afford the cost of running a quality program and paying either market rate rent or debt on a facility to house the program. The *Rural Collaborative* combined equity grants with low-cost, long-term loans and loan guarantees to make facility development financially feasible for providers. The typical Collaborative project costs about $475,000 and serves 60 children, representing a capital cost of just under $8,000 per child. Just over 50% of the total cost was covered by grant funds, about half from HHS and the other half from localities. These grants leveraged the remaining 50% of the financing in the form of loans from USDA and private banks. The USDA Community Facilities Program's below-market rates and generous repayment terms— up to 40 years at less than 5% interest-- greatly reduced the cost of borrowing, and enabled the local providers to support a higher proportion of the development costs with loans.

With specialized technical support and $2.7 million in financial resources from the *Rural Collaborative*, eight nonprofit community-based organizations are developing new Head Start and child care facilities serving 468 children and supporting employment for hundreds of parents. These facilities represent over 50,000 square feet of quality community facility space, with a total development value of almost $4 million.

Temporary capital is borrowed. Some of it is available on very favorable terms. A number of national foundations in particular, such as the Ford Foundation and the MacArthur Foundation, make "program related investments" (PRIs). Some religious organizations will also make loans on

favorable terms to development lenders. These are philanthropically motivated loans, often at very favorable interest rates. Banking institutions seeking to secure credit for making Community Reinvestment Act-eligible investments and loans are using a relatively new investment instrument known as an "equity equivalent investment." Although these instruments are structured like a loan, there is no expectation that the development lender that has borrowed the funds will ever trigger the provisions of the loan agreement that would require repayment. This type of instrument is sometimes referred to as "quasi-equity"; it functions like equity but is structured like debt.

San Francisco's Capitalization Strategy: Using HUD Section 108 Loans

In 1998, the City and County of San Francisco, along with the Miriam and Peter Haas Fund, formed the Child Care Facilities Fund, a public-private partnership administered by the Low Income Housing Fund. To raise loan capital, the city administration decided to earmark $10 million of previously approved Section 108 borrowing authority. Section 108 of the Housing and Community Development Act of 1974 authorizes the US Department of Housing and Urban Development to issue loan guarantees backed by future Community Development Block Grants (CDBG) receipts and other collateral. With this security, HUD goes to the capital markets to raise capital. Because the federal government is the borrower and the repayment is secured, HUD achieves favorable terms on the funds it borrows on behalf of CDBG-eligible jurisdictions.

San Francisco uses this borrowing authority as it is needed. A total of eight child care facilities projects have received loan commitments totaling $4.3 million. The loans range from $196,000 to $1.08 million. To date, two projects have begun construction. Because the city only borrows from HUD once a year, it provides interim financing. Then, in a number of months, the city will bundle all the projects to be financed under the Section 108 authorization and close on the HUD loan.

This is a very effective means for raising capital for a child care facilities fund. However, San Francisco also does one more thing. It provides debt service support. In other words, it actually helps some of the Child Care Center Development Loan Program borrowers make loan repayments on these loans, thereby directly subsidizing both the principal and interest expense. The city's Department of Human Services has been authorized to pay up to 80% of the debt service using funds appropriated by the City Council from the city's general fund. Although these commitments do not take a contractual form binding the city to continue to contribute to the payment of debt service for the life of the loan, because the city cannot allow itself to default on its loan with HUD, it is generally assumed that the city's debt service commitment is secure for the full term of the loan.

Banks and insurance companies, especially community investment or socially conscious investment arms of these institutions, also make loans to development lenders. These loans are usually at conventional rates and are more likely to be available to established development lenders for lending to markets in which the lender has a known track record.

In addition to these capitalization strategies, there have been a number of particularly creative approaches employed by Self-Help, the Community Investment Collaborative for Kids (CICK), a program of the Local Initiatives Support Corporation, and the San Francisco Child Care Facilities Fund. Each of these are described in brief case studies found in this section.

Conclusion

Our ancestors probably did not know that they needed fire until they had it. The same can be said of facilities debt for community-based child and family services. Only a relatively small number of larger, diversified and more sophisticated nonprofit agencies do capital planning and use debt as a financing tool. But as pioneering nonprofit facilities programs and child care loan funds have

demonstrated in localities around the country, the capital needs of these organizations are serious. Without investments in facilities, the supply of services is inadequate and their quality wanting. The availability of affordable debt and technical assistance has stimulated a development response— a series of systemic changes-- that often leads to higher levels of capital investment, even by small community-based organizations.

Creating a loan fund from whole cloth is especially difficult. The most successful strategy appears to be to identify an existing development lending institution that is prepared to focus on the needs of organizations providing community-based child and family services. Such a lender can develop a specialization in the physical and locational needs of these organizations and their users. They can customize loan programs and deliver technical assistance that meet the unique needs of these agencies. As established lenders, they have systems in place to originate and service loans. They have the credibility with investors to leverage the capital needed to launch the lending program. Finally, theirs is a growing industry of community development finance institutions, including child care and facilities loan funds, that have developed new investment vehicles like equity equivalent investments and the CDFI Fund to capitalize their expanding lending activities.

Delivering quality child and family services in the community is extremely challenging. Providers cobble together operating budgets based on inadequately funded state service contracts, foundation grants, and private philanthropy. Physical capital needs seem beyond reach. Facilities loan funds represent a strategic investment in removing the many barriers to improved services by giving organizations new tools and options. To be sure, these facilities lending programs face many challenges. But, remarkably, the repayment record of their borrowers is strong. These are good loans. In the final analysis, these lending programs will be judged as successes because the supply and quality of community-based services have improved. The preliminary evidence suggests that indeed, physical capital investments are an important component of any comprehensive initiative to improve services for children and their families.

Appendix A: Glossary

Amortization – The process of making periodic principal and interest payments in order to completely repay a loan. The amortization period is the length of time during which a borrower repays a loan. For example, a typical home mortgage might be amortized monthly for 20 years.

Assign – The process of arranging or conveying a borrower's interest to a lender in the event of a default.

CDFI – See "Community Development Finance Institutions."

Collateral - A lender's legally enforceable claim to take and sell assets pledged by a borrower to protect the lender against financial loss in the event the borrower defaults on the loan.

Community Development Finance Institutions – This term generically refers to a wide range of community development lending organizations, ranging from large national nonprofit intermediaries such as the Local Initiatives Support Corporation to small community loan funds. Since the passage of the Community Development Banking and Financial Institutions Act of 1994, it also refers specifically to those community development lenders eligible for the federal funds authorized by the act.

Community Reinvestment Act – Federal statute which since 1977 has outlawed redlining: the practice of restricting credit to low-income or minority neighborhoods within a bank's business area. The CRA has been credited with increasing the availability of capital in these communities.

CRA – See Community Reinvestment Act.

Creditworthiness – The lender's assessment of a borrower's qualifications for a loan based on credit history, net worth, collateral, and other factors bearing on the ability to repay a loan.

Debt Service – The amount of principal and interest that a borrower pays to the lender. A monthly mortgage payment, for example, is debt service – part principal repayment and part interest. The monthly mortgage may also include an escrow payment for taxes and insurance. While the lender may collect and later make tax and insurance payments for its borrowers, only principal and interest payments are considered be debt service.

Default – A borrower's failure to meet an obligation to a lender under the terms of a loan agreement, such as failing to make required payments of interest and principai payments.

Equity – In a real estate transaction, equity is the cash (or cash equivalent) invested by the owner. The balance of the funds to complete the transaction comes in the form of borrowed money (also called debt). The more equity available, the less the owner has to borrow and the lower the risk to the lender.

Foreclose – The legal process used by a lender after a loan default to take possession of assets put up by a borrower to secure that loan.

Guarantor – One who agrees to repay the lender all or part of the principal and interest on behalf of a borrower in the event that the borrower fails to make these payments as required by the loan agreement.

Line of credit – A pre-approved loan that a borrower can tap as needed. Conventional consumer credit cards are essentially lines of credit allowing the cardholder to spend up to the pre-approved credit limit.

Loan origination – The process of making and documenting a loan, including preparation and execution of loan documents (the loan agreement, promissory note, security agreements, etc.), recording the documents at a public registry, and disbursing funds to the borrower.

Loan servicing – The administration of the loan after closing including making disbursements, collecting payments, monitoring the performance of the loan and the security, keeping the documents, and discharging the promissory note and any liens once the borrower has satisfied all of its obligations to the lender.

Loan-to-value ratio – The mathematical expression of the cushion lenders require between the amount of money being lent and the appraised value of the property being financing. A 70% loan means that the lender will not lend more than 70% of the value of the underlying asset.

Net Worth – The total financial value of a business, organization, or individual after deducting all amounts it owes. In other words, total assets less total liabilities.

Opportunity Cost – Foregone income. The value that an organization or individual would have realized by pursuing a more attractive alternative investment.

Option – A contract with the owner of a piece of property agreeing to hold the property off the market for a specified period of time and to sell the property to the holder of the option during that period should the prospective purchaser decide to complete the transaction. In exchange for giving the purchaser of the option the exclusive right to purchase the property, the potential buyer makes a payment to the seller regardless of whether the property is purchased. The price of the option is modest compared to the cost of the land, and it gives the buyer the time to secure financing, zoning, conduct site analysis, and perform other predevelopment tasks. The buyer exercises the option to purchase the property only if it becomes clear that the proposed project can be completed.

Security – A lender's legally enforceable claim to assets pledged by the borrower or a third party to protect the lender against financial loss in the event of a default or foreclosure. See also collateral and guarantor.

Soft costs – While "hard costs" are the "bricks and mortar construction costs" of developing a facility, soft costs refer to a broad category of professional services, premiums, and fees to cover building and other permits, architectural services, developer overhead, and insurance.

Subordinated loan – A loan that is "junior" to another loan to the same borrower entitling the "senior" lender to a prior claim on repayments and collateral should the borrower default or be foreclosed upon. A subordinated loan is riskier than senior debt. To attract commercial bank capital into a project, a development lender typically must agree to subordinate its interest to the bank's if both institutions participate in the financing.

Transaction costs – All financial transactions cost money. For a lender, the costs of underwriting a loan – analyzing a borrower's financial condition, researching credit history, etc. – legal fees to document and close a loan, overhead, and loan monitoring and servicing expenses after the loan is closed comprise the transaction costs. The loan interest must be sufficient to cover these transaction costs, plus the cost the bank pays on the money it re-lends to its borrowers and the bank's profit, to be worthwhile from the lender's perspective.

Underwriting – The credit analysis performed by a lender to determine whether to make a loan and how to structure it.

Useful life – The length of time an asset can be productively used before wearing out and presumably losing its economic value.

Working capital – The financial resources required to meet immediate obligations in anticipation of earned income. In other words, funds used during the length of time required to convert services (which involves a cash outlay) into cash payments for those services. Human service organizations often require working capital in order to pay staff on a biweekly basis in anticipation of public, sector contract reimbursement payments that arrive a month or more after services are delivered and payrolls are met.

Appendix B: Proforma for the Child Care Capital Investment Fund

The following three pages contain a partial financial projection prepared for the Child Care Capital Investment Fund. The full proforma projected the financial performance out for 16 years. These projections contain three elements:

- The first is a set of assumptions for the loan products and lending volume for the Fund's 5-year pilot phase.
- The following page contains an income statement prepared as a cash flow projection.
- The third and last page contains a proforma balance sheet.

Projections like these form the core of the business plan for a loan fund. All of the critical financial and performance assumptions are imbedded in the projections: number of loans made each year, projected loan losses, operating costs, and the like. A bank, foundation, or governmental agency considering a loan or grant to help capitalize the fund can examine a set of statements like this

and ask informed questions about the assumptions to decide whether they think the fund will be viable.

Child Care Capital Investment Fund Proforma

CCCIF - ASSUMPTIONS

	YR1	YR2	YR3	YR4	YR5	TOTAL
A. Fund Use Distribution						
Term Loans	90%	90%	65%	65%	65%	
Balloon Loans	0%	0%	0%	0%	0%	
Mini Loans	5%	5%	10%	10%	10%	
Micro Loans	0%	0%	0%	0%	0%	
Loan Guarantees	0%	0%	0%	0%	0%	
Equity Loans	0%	0%	15%	15%	15%	
Technical Assistance Loans	5%	5%	5%	5%	5%	
Technical Assistance Services	0%	0%	5%	5%	5%	
	100%	100%	100%	100%	100%	
B. Annual Funds Committed						
Term Loans	0	142,200	612,300	727,100	425,000	1,906,600
Balloon Loans	0	0	0	0	0	0
Mini Loans	0	7,900	94,200	39,837	60,000	201,937
Micro Loans	0	0	0	0	0	0
Loan Guarantees	0	0	0	0	0	0
Equity Loans	0	0	141,300	0	0	141,300
Technical Assistance Loans	0	7,900	47,100	28,250	25,000	108,250
Technical Assistance Services	0	0	47,100	136,575	75,000	258,675
Total Committed	0	158,000	942,000	931,762	585,000	2,616,762
C. Funded Debt Service Reserve	100,000	0	0	0	0	
D. Fund's Financial Products	**Rate**	**Term**	**Amort**	**Avg. Loan**	**Loss Rate**	
Term Loans	5%	7	7	85,000	10%	
Balloon Loans	5%	7	20	55,000	10%	
Mini Loans	5%	5	5	5,000	30%	
Micro Loans	5%	4	4	1,000	20%	
Loan Guarantees	5%	3	7	50,000	10%	
Equity Loans	1%	1	100	50,000	90%	
Technical Assistance Loans	0%	1	1	10,000	20%	
Technical Assistance Services	0%	0	0	3,000	100%	
E. Interest on Deposits	3.00%					
F. Guarantee Repayments	75%	of guarantees released after three years. Balance of guarantees are called and treated as Term Loans.				
G. Legal Expenses	$2,500	are projected in closing costs for each loan guarantee, or term, balloon, & equity & equity loan. Borrowers are responsible for the Fund's legal costs in excess of $2,500.				
H. Number of Loans Originated						
Term Loans	0.0	1.7	7.2	7.1	4.5	20
Balloon Loans	0.0	0.0	0.0	0.0	0.0	0
Mini Loans	0.0	1.6	18.8	18.6	11.7	51
Micro Loans	0.0	0.0	0.0	0.0	0.0	0
Loan Guarantees	0.0	0.0	0.0	0.0	0.0	0
Equity Loans	0.0	0.0	2.8	2.8	1.8	7
Technical Assistance Loans	0.0	0.8	4.7	4.7	2.9	13
Technical Assistance Services	0.0	0.0	15.7	15.5	9.8	41
	0	4	49	49	31	133
I. Years	Years correspond to calendar years beginning with 1991					

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CCCIF-CASH FLOW	YR1	YR2	YR3	YR4	YR5	YR6	YR7	YR8
Cash Flow from Operating Activities								
Income								
Grants	443,166	536,370	253,720	220,000	235,159	0	0	0
Interest on Guarantees	0	0	0	0	0	0	0	0
Interest on Deposits	14,240	33,652	44,064	23,845	14,053	13,880	14,826	15,908
Loan Interest	0	3,177	34,634	58,550	67,450	55,230	42,414	29,325
Loan Fees	0	0	0	0	0	0	0	0
Total Income	**457,406**	**573,199**	**332,418**	**302,395**	**316,662**	**69,110**	**57,240**	**45,233**
Expenses								
Operational Costs								
Administration	0	0	30,000	90,000	30,000	30,000	30,000	30,000
Marketing	0	0	75,000	50,000				
Other	0	0	15,000	15,000				
Capital Grants	0	0	100,000	0				
Legal	0	10,663	25,074	24,801	15,571			
Total Operational Costs	0	7,568	245,074	179,801	45,571	30,000	30,000	30,000
PRI Interest	0	3,111	11,060	11,042	11,127	8,666	6,209	4,259
Loan Loss Reserves	0	22,574	226,080	223,625	140,400	0	0	0
MCS Costs	0	0	0	0	0			
Tech. Assitance Grants	0	0	47,100	46,588	29,250	0	0	0
Equity Loans	0	0	0	0	0	0	0	0
Total Expenses	**0**	**33,243**	**529,314**	**461,106**	**226,348**	**38,666**	**36,209**	**34,259**
Excess/Deficit of								
Income over Expenses	457,406	539,956	(196,896)	(158,710)	90,314	30,444	21,031	10,974
Non Cash Outlays								
Loan Loss Adjustment	0	22,574	226,080	223,625	140,400	0	0	0
Net Cash Flow from Operations	**457,406**	**562,530**	**29,184**	**64,913**	**230,714**	**30,444**	**21,031**	**10,974**
Cash Flows from Loan Activities								
Sources								
PRI Loans								
Ford PRI		1,000,000						
Ford Debt Service Reserve		100,777	5,246	3,204	3,481	3,862	4,359	4,387
Other PRI Loans								
Total PRI Loans	0	1,100,777	5,246	3,204	3,481	3,862	4,359	4,387
Repayments	0	8,007	103,266	218,151	276,297	274,646	262,810	260,967
Total Sources	**0**	**1,108,784**	**108,512**	**221,355**	**279,777**	**278,508**	**267,169**	**265,354**
Uses								
Loans	0	158,500	894,400	885,174	555,750	0	0	0
Converted Guarantees	0	0	0	0	0	0	0	0
PRI Loan Repayments								
Ford Foundation						250,000	250,000	200,000
Ford Debt Service Reserve		0	0	0	0	0	0	0
Other PRI Lenders								
Total PRI Loan Repayments	0	0	0	0	0	250,000	250,000	200,000
Total Uses	**0**	**158,500**	**894,900**	**885,174**	**555,750**	**250,000**	**250,000**	**200,000**
Net Cash Flow from Lending	**0**	**950,284**	**(786,388)**	**(663,819)**	**(275,973)**	**28,508**	**17,169**	**65,354**
Net Cash Flow	457,406	1,512,814	(757,204)	(598,906)	(45,259)	58,952	38,200	76,328
Beginning Cash Balance	0	457,406	1,970,219	1,213,015	614,110	568,851	627,803	666,003
Ending Cash Balance	457,406	1,970,219	1,213,015	614,110	568,851	627,803	666,003	742,331

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CCCIF - BALANCE SHEET	END YR1	END YR2	END YR3	END YR4	END YR5	END YR6	END YR7	END YR8
ASSETS								
Cash	457,405	1,999,440	1,106,992	504,662	456,143	511,233	645,074	617,018
Restricted Cash								
Guarantees	0	0	0	0	0	0	0	0
Rsrd Debt Serv Reserve								
Debt Service Reserve	0	100,000	100,000	100,000	100,000	100,000	100,000	100,000
Accumulated Interest	0	777	6,023	9,227	12,708	16,570	20,929	25,916
Total Rsrd Debt Serv Reserve	0	100,777	106,023	109,227	112,708	116,570	120,929	125,916
Total Restricted Cash	0	100,777	106,023	109,227	112,708	116,570	120,929	125,916
Receivables								
Loans Receivable	0	150,400	942,127	1,609,150	1,888,603	1,813,957	1,351,147	1,090,100
Cum. Loan Loss Reserve	0	(22,574)	(248,654)	(472,277)	(612,677)	(612,677)	(612,677)	(612,677)
Net Receivables	0	127,974	693,473	1,136,873	1,275,927	1,001,280	738,470	477,503
Total Assets	457,405	2,098,138	1,906,489	1,750,983	1,844,777	1,629,084	1,404,473	1,220,434
LIABILITIES								
Notes Payable	0	1,000,000	1,000,000	1,000,000	1,000,000	750,000	500,000	300,000
Debt Service Reserve	0	100,777	106,023	109,227	112,708	116,570	120,929	125,916
Total Liabilities	0	1,100,777	1,106,023	1,109,227	1,112,708	866,570	620,929	425,916
NET WORTH								
Unrestricted Fund Balance	457,405	997,361	800,466	641,756	732,069	762,514	783,544	794,518
Total Liabilities & Fund Balance	457,405	2,098,138	1,906,489	1,750,983	1,844,777	1,629,084	1,404,473	1,220,434

Appendix C: The Community Development Financial Institutions Fund

The following information is from the Coalition of Community Development Finance Institutions' web page, www.cdfi.org.

Purpose

The central purpose of The Community Development Banking and Financial Institutions Act of 1994 (the CDFI Act) was to create a CDFI Fund to promote economic revitalization and community development by investing in and assisting CDFIs through equity investments, capital grants, loans, and technical assistance support. CDFIs can use this financial assistance to support an array of community development activities, including housing for low-income people, businesses owned by low-income people, basic financial services, commercial facilities that promote job creation or retention, and technical assistance. The Fund seeks to build the capacity of the individual institutions it finances to bolster their ability to start, expand, and improve their programs, thus strengthening and expanding the national network of CDFIs.

Eligibility & Selection Criteria

To qualify for a CDFI Fund award, CDFIs must meet the following six eligibility criteria:

- Have a primary mission of promoting community development;
- Serve an investment area or targeted population;
- Provide development services and equity investments or loans;
- Maintain accountability to residents of its investment area or targeted population;
- Not be a public agency or institution; and
- Be primarily a financing entity.

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These criteria purposefully have been left unrestrictive to accommodate both the different institutional structures of CDFIs and the need to be responsive to diverse markets. Once an institution has met the eligibility criteria, the Fund considers a number of weighted selection criteria such as management experience, the extent of economic distress in the market served, the amount of match commitment, etc., to serve as guidelines in the decision-making process.

Assistance

The Fund can provide several kinds of assistance to CDFIs for a range of financing activities. Specifically, it can assist these financial intermediaries through equity investments, deposits, loans, grants, and credit union shares. The Fund also provides technical assistance directly, through grants, or through contracts with specified organizations. The Act authorizes awards of up to $5 million dollars over 3 years, except in cases where a CDFI is franchising into a new area, and then the award cap is increased to $8.75 million.

CDFIs can use the financial assistance for a wide variety of purposes, including support or development of:

- basic financial services;
- housing for low-income people;
- commercial facilities that promote revitalization, community stability, or job creation or retention;
- businesses that provide jobs for low-income people, that are owned by low-income people, or that enhance the availability of products and services to low-income people;
- community facilities;
- other businesses and activities deemed appropriate by the Fund; and
- technical assistance for capacity-building, training, and development of programs, investments or loans.

Financial assistance from the Fund must be matched on a one-to-one basis from non-federal sources with the same type of funds (i.e., equity for equity), except in limited cases where CDFIs have severe constraints such as, a) total assets of less than $100,000; b) serving rural or nonmetropolitan areas; or, c) requesting less than $25,000. In these cases, the Fund has the discretion to reduce the match by up to 50% or create flexible matching requirements.

Appendix D: Case Studies of Two Sample CCCIF Loans

What difference do facilities loans and loan funds make? The following case studies provide examples of two projects and the difference that a loan can make. Both projects relied heavily on grant funding. Loans represented 25 to 35% of the total costs: That was all the programs could support. But, this enabled both programs to significantly increase the level of investment producing important quality improvements. In both cases, the loan fund also played a pivotal technical assistance role and administered public- and private- sector grants that made up much of both projects' funding.

Case Study

Sponsor: Fenway Community Development Corporation

Service Provider: YMCA of Greater Boston

Site: 64-70 Burbank Street, Fenway, Boston

Project Summary: The project is the start-up of a new school-age program in the East Fenway. It is a collaboration of Fenway CDC, a community-based, nonprofit developer, and the YMCA of Greater Boston, one of the largest providers of child care and after-school programs in the city.

The space was an existing 2,400-square-foot community room in the basement of a multi-family development. In order to convert it to high-quality program space, the scope of construction included selective demolition, new flooring, upgraded heating and ventilation, electrical work, and the installation of several walls. In addition, Fenway upgraded the kitchen, installed a new bathroom, and built in shelves, benches, cubbies, and counters for a computer area.

Impacts:

1. Creation of 39 new school-age slots.
2. Rationalized layout creates separate activity areas, including a space for quiet activities.
3. Built-in cubbies and ample storage reduces clutter, enhances program operations.
4. Quality finishes and coordinated color scheme create an inviting atmosphere.
5. Layout focused on interior light-well creates natural light in a challenging basement space.

Costs:

Construction:	$116,100
Soft Costs*:	$47,559
Total Development Costs:	$163,659
Cost per slot:	$4,196
Cost per square foot:	$68
CCCIF Loan	$57,000
Loan as a percent of Total Costs	35%

*Soft Costs include fees and permits, architectural services, furniture & equipment, developer overhead, licensing, marketing, and insurance.

Case Study

Provider: Dimock Community Health Center
Site: The Gatehouse Preschool at 30 Dimock Street, Roxbury, MA

Project Summary: Dimock Community Health Center (which was formerly the New England Hospital for Women and Children), a nonprofit corporation, has been providing a wide range of health and support services for women and their children for more than 135 years. The project is an expansion of the preschool program Dimock began about six years ago.

The Gatehouse Preschool is located on the ground floor of a building that houses the Roxbury office of the Department of Social Services on Dimock's campus. Construction of the space required complete build out of the 3,800-square-foot floor of this building and created three additional classrooms to serve 54 more preschool-age children in a full-year program. The work performed required substantial rehabilitation, such as: selective demolition; constructing walls; floors, and ceilings; installing windows and glass partitions; painting, carpentry, fireproofing, and installing the electrical systems; and upgrading the heating and ventilation systems. Construction also included the creation of a kitchen, new bathrooms, built-in shelves and cubbies, and a permanent playhouse.

Impacts:

1. Creation of 54 new preschool-age slots.
2. Creation of an atmosphere which encourages and promotes the developmental progress of children.
3. Generous use of glass gives classrooms a sense of spaciousness and allows easier monitoring of adjacent rooms, adding to the center's sense of security and supervision.
4. Use of curved and skewed walls softens the feel of the space and adds interest and life.
5. Bright colors give space a year-round sense of cheerfulness.
6. Access to sinks and water in each classroom and availability of child-friendly bathrooms make classroom management easier for teachers.

Costs:

Construction:	$375,000
Soft Costs*:	$113,200
Total Development Costs:	$488,200
Cost per slot:	$9,040
Cost per square foot:	$98
CCCIF Loan	$120,000
Loan as a percent of Total Costs	25%

*Soft Costs include fees and permits, architectural services, furniture & equipment, developer overhead, licensing, marketing, and insurance.

Appendix E: Sample Loan Fund Application

CHILD CARE CAPITAL INVESTMENT FUND

APPLICATION

Organizations needing assistance or clarification in responding to this application are encouraged to contact Victoria Bok, Program Manager at (617) 727-5944, ext. 106.

Date Submitted:

ORGANIZATIONAL INFORMATION

1. Name of Organization:

If not the same, Name of Organization with OCCS license:

_____

2. Address:

3. Phone Number:

Fax Number:

E-Mail:_

4. Contact Person: Name

Title

5. Are you a 501(c)3 non-profit organization? (NOTE: only non-profit organizations are eligible for assistance from the FUND.)

_____ Yes

_____ No

6. If this organization is a subsidiary of another corporation, please note the legal name of the parent corporation.

_____

7. Do you operate a Family Child Care System?

_____Yes

_____No

If so, how many providers are under contract with your system? _____

8. Does your organization receive funding from the United Way?

_____Yes

_____No

9. How long has your organization been providing child care?

_____ Yrs.

10. Do you provide child care only or are you a multi-service organization?

_____Child care only

_____Multi-service organization

11. Is your organization minority-managed? (A minority-managed agency is one in which the chief professional officer and/or the chief volunteer officer, and at least 50% of the Board are minorities.)

_____Yes

_____No

12. Is your organization women-managed? (A women-managed agency is one in which the chief professional officer and/or the chief volunteer officer, and at least 50% of the Board are women.)

_____Yes

_____No

13. For multi-site programs, please list the sites where child care is provided by your organization.

Site Name	*Street Address and Municipality*
1.	
2.	
3.	

Please put an asterisk by the site of the proposed project(s).

14. Please fill in the following grid for each site identified in #13, noting the number of slots that are currently filled in each category. Please photocopy as needed for each site.

SITE NAME:

Program Type	*OCCS Basic*	*OCCS Protective/Supportive*	*Voucher*	*Community Partnership*	*Head Start*	*Private Pay*	*Other**	*Total Slots Currently Filled*	*T Lic Ca*
Infant									
Toddler									
Pre-School									
School Age									
TOTAL									

*Other Includes:

15. Please fill in the following grid for each **PROPOSED PROJECT SITE**. If your organization is proposing an expansion in the number of available slots, please prepare the grid based on expansion plans.

SITE NAME:

Program Type	*OCCS Basic*	*OCCS Protective/ Supportive*	*Voucher*	*Community Partnership*	*Head Start*	*Private Pay*	*Other**	*Total Slots Currently Filled*	*To Lice Cap*
Infant									
Toddler									
Pre-School									
School Age									
TOTAL									

*Other Includes:

The FUND will use the same definition of low income as the Department of Social Service. This is at or below 50% of the state's median gross income for children without special needs and at or below 75% of the state's median gross income for children with special needs. As of 6/99, this translates to a maximum of:

Without special needs	With special needs
$22,344 for a family of two	$32,064 for a family of two
$23,172 for a family of three	$33,252 for a family of three
$27,588 for a family of four	$39,588 for a family of four
$32,004 for a family of five	$45,924 for a family of five

15a. How many low-income children will be served by the **PROPOSED PROJECT SITE?**

(NOTE: This figure should be the number of low-income children served at the site where

the project will take place **only**.)

15.b What percentage of this is the total number of children to be served at the **PROPOSED PROJECT SITE?**
(NOTE: To be eligible for FUND support, this percentage must be a minimum of 30%.)

16. How many (if any) children will the **PROPOSED PROJECT SITE** serve of the following special populations?
(Numbers served in each category may be duplicative, i.e. a homeless African-American child should be counted in both the "minority" and "children of homeless families" categories.)

_____Minorities

_____Children of Homeless Families

_____Children of Teenage Parents

_____Children with Special Needs

17. Please indicate the size of the waiting lists per site, for each proposed project site.

	Number on Waiting List			
Site Name	Infant	Toddler	Pre-school	School-Age

18. How often do you update your wait-list?

Never ___ 0 to 3 months ___ 3 to 6 months ___ 6 to 12 months ___N/A (don't maintain lists)___

19. When did you last update your waiting list? Date: _____

20. What is the licensing status of the proposed site?

Licensed by OCCS, date first licensed _____

OCCS License pending _____

Other _____

21. Does your agency have other accreditation?

_____Yes

_____No

If so, from whom? If pending, please describe.

FINANCIAL PLANNING

NOTE: If you are a multi-service organization, please make sure that your answers to questions about financial planning, loan history, and litigation refer to your entire organization, not just your child care program.

22. Please check which statements your organization prepares and how often:

	Monthly	*Quarterly*	*Yearly*	*Do Not Prepare*
Balance Sheet				
Cash Flow Projections				
Income and Expense Statements				
Other (please specify)				

23. Who prepares these financial statements? Please state if this person is on staff or is a

contractor. (Name and Title)

24. Who audits your financial statements? (Note: If your budget is over $250,000, the FUND requires audited statements.) How often are you audited? When were you last audited?

25. Are these statements subject to your Board's review? How frequently?

26. Are your financial statements prepared on a cash or an accrual basis?

27. What is your fiscal year? (i.e., July 1 to June 30; January 1 to December 31)

28. Does your organization currently have any outstanding debt with the Internal Revenue Service and/or the MA. Dept. of Revenue? If yes, please explain. Have you ever been assessed a penalty by the IRS and/or the Dept. of Revenue? If so, when?

29. Has your organization been involved in any litigation in the past year or at this time? If so, please describe.

30. Has your organization applied to other funding sources for this project? To whom? What is the status of your application(s)? Please attach any letters of support or commitment.

31. Does your organization have any previous borrowing experience? If so, please describe how much was borrowed, for what purpose and from whom. Were there any problems encountered during the course of any of these loans? Please explain.

Lender	*Amount Borrowed*	*Date Loan Began*	*Purpose/ Type of Loan*	*Interest Rate*	*Monthly Payment*	*Due Date*	*Current Balance*

PROPOSED USE OF FUNDS

Please provide as much information as is currently available in response to question #25 to 30 below. You do not need to have complete or final answers to these questions in order to apply to the FUND for assistance. Please attach additional pages as necessary.

32. Describe the need for capital expenditures to either increase the capacity or improve the quality of your program, and how your proposed project will address this need.

33. Please describe the project for which you seek assistance. For renovation projects, include the current physical condition. Attach whatever supplemental information you have, such as architectural drawings.

34. How has the project been planned to date? Who has participated?

35. Do you require or expect to use any technical assistance in moving forward with this project (i.e., architect, engineer, attorney, program consultant, project manager)? If so, please describe what type of technical assistance is needed. If you know the cost of this assistance, please detail this as well.

36. How has the project budget been determined? Have you received contractor estimates? If so, please attach.

37. Describe the loan amount requested. This figure should be consistent with the FUND's guidelines (per project loan maximum of $300,000).

38. What kind of collateral will be available as security for a loan (building, land, lease, general corporate assets, etc.)?

39. Please outline the expected project timeline.

40. Please outline site conditions known at this time (i.e. zoning, historical, environmental, etc.).

41. What is your program's occupancy status. Please check all that may apply.

Currently Proposed

Own the building _____ _____

rent _____ _____

no lease _____ _____

short-term lease (1 year) _____ _____

long-term lease (1 year) _____ _____

pay no or reduced rent _____ _____

42. How did you find out about the Child Care Capital Investment FUND?

I certify that the information provided in this application is true and correct. I agree that my organization will cooperate with all necessary procedures to process this request. I understand that FUND staff may contact my organization's other lenders and creditors as part of the application review process, and I hereby authorize these institutions to cooperate with the FUND's review. I further agree to cooperate in any evaluation process conducted to review the effectiveness of the Child Care Capital Investment FUND, as well as any efforts to publicize the FUND.

Executive Director Signature_

(Print or type name of Executive Director)

Board President Signature

(Print or type name of Board President)

Date

SUPPLEMENTARY MATERIALS

Please provide, as attachments or appendices, the following information **in duplicate** about your organization.

1. **Organizational Financial Information,** including:

- current year's operating budget;
- three most recent audited financial statements, if your organization's annual budget is over $250,000, or if not, three certified financial statements; and
- unaudited year-to-date financial statement for the current fiscal year.

2. **Projected Operating Budget showing loan repayment** - Please provide an operating budget which includes a specific line item reflecting loan repayment to the FUND. For new programs/sites or major expansions, please include a 3-to-5-year operating budget.

If you are applying for technical assistance as the first stage of a project, you do not need to submit this budget at this time.

3. **Copy of current OCCS license**.

4. **Copy of program information (brochure, parent handbook, etc.).**

5. **Proof of 501(c) 3 status**.

6. **Copy of other accreditation or letter stating intention to seek accreditation.**

7. **Resumé of Child Care Program Director and Organization's Executive Director**.

8. **Board of Directors - list of members, including affiliations**.

9. **Total project budget, including all sources and uses of funds.** [Please include any supporting information, such as contractor estimates, letters of funding commitment, etc.]

10. **Cash flow budget, if available**.

11. **Architectural drawings, if available, or other illustrations of proposal.**

12. **Copy of lease or title.** [If renting, submit written approval from site owner.]

Please call the FUND if you require assistance on completing the above requested documentation. Remember - provide 2 copies of all requested information.

Please mail 2 copies of your completed application and 2 copies of all supplementary materials to:

Victoria Bok, Program Manager

Child Care Capital Investment FUND

c/o CEDAC

18 Tremont Street, Suite 1020

Boston, MA 02108

THANK YOU. WE'LL GET IN TOUCH WITH YOU ONCE WE HAVE PROCESSED YOUR APPLICATION.

Appendix F: Sample Loan Program Guidelines

San Francisco Section 108 Child Care Center Development Loan Program

PROGRAM GUIDELINES

The City and County of San Francisco announces the availability of funds for the Section 108 Child Care Center Development Loan Program (CCCDLP) on an open application basis. The program is overseen by the Mayor's Office of Community Development and is administered in cooperation with the Child Care Facilities Fund of the Low Income Housing Fund, the Department of Human Services, and the Department of Children, Youth and Their Families. The CCCDLP provides long term loans to support the capital costs associated with the development of new child care slots in San Francisco as more fully described below.

1. Applicants must meet the following criteria:

a. Develop a facility located in the City and County of San Francisco.

b. Serve residents of the City and County of San Francisco and be available to the members of the community as a public facility. Preferences cannot be contrary to public access.

c. Possess a valid operating license for child care services from the California Department of Social Services, Community Care

Licensing Division or be in the process of developing a licensed child care facility.

d. Be a secular, nonprofit, 501(c) 3 organization or have a secular, nonprofit, 501(c) 3 fiscal sponsor or be a City agency.

e. Demonstrate that a minimum of 51% of the children to be served by the program will be low or moderate income in accordance with Department of Housing and Urban Development (HUD) guidelines for area median income. See Exhibit A for guidelines.

f. Demonstrate site control of the subject property through ownership or a lease to last the duration of proposed financing (up to 15 years).

g. Be able to provide adequate security for the loan, in for the form of a deed of trust on the property, a security interest in the personal property, or other security acceptable to the City.

h. Demonstrate an ability to repay the loan on the terms awarded.

i. Be able to obtain all funds other than the Section 108 CCCDLP loan which are required for the project.

j. Demonstrate community support for the proposed project.

k. Demonstrate a need for the proposed financing.

l. Demonstrate an ability to meeting federal and local requirements for funding. See Exhibit B for details.

2. Applications will be prioritized and analyzed according to the extent to which they achieve the following additional criteria.

a. Create new child care capacity for a reasonable cost and/or raise other funds to support the project.

b. Demonstrate an ability to use the funds expeditiously to create child care.

c. Provide child care in geographic areas of high need as determined by the Department of Human Services.

d. Serve families transitioning from welfare to work.

e. Provide care to specialized populations such as children with special health needs and infants or toddlers, and/or provide specialized care such as after hours, sick or drop-in care.

f. Demonstrate concrete linkages to the community and to other services for

children and families served.

g. Priority will be awarded to nonprofit applicants.

3. Loans are available on the following terms.

a. Loan Amount: The minimum loan available is $75,000. The maximum loan available is $15,000 per child care slot. The actual loan amount will be determined by the project cost, security for the loan, and the applicant's ability to repay the loan.

b. Loan Term. Loan terms of up to 15 years are available on a fully amortizing basis.

c. Interest Rate. Rates are tied to the City's cost of funds at loan closing. For loan analysis, interest rates of 7.0% are being estimated.

d. Fees. Origination fees of $600 per loan will be collected at time of loan commitment. Document fees of $375 per loan will be collected at time of loan closing.

e. Payment Assistance. Loan payments may be subsidized by the City for eligible providers up to a maximum of 80% of total payments and will be determined and negotiated on a case by case basis during loan underwriting. When considering requests for loan payment assistance, the following factors will be considered:

- Number of low and moderate income children, and/or current and former welfare recipients served;

- Location of program;

- Provision of care to specialized populations and/or provision of types of care in high demand;

- Linkages to the community and to other services;

- Cost of developing care and/or other funds raised;

- Cost of operating program; and

- Lack of funding from other sources.

f. Security/Collateral: Lien on subject property no less than second position or alternative form of security as determined on a case by case basis. Financing of improvements on leased property is eligible. However, a lease for the term of the proposed loan and assignment of the lease must be provided.

g. Federal and Local Requirements: Financed projects are subject to federal

and local requirements including, but not limited to: Davis-Bacon, prevailing wage, first source hiring, environmental clearance, historic preservation, Americans with Disabilities Act, and non-discrimination.

h. Prepayment. Pre-payment of loans is not allowed.

i. Uses of Funds. CCCDLP loans can be used to finance, one time facilities costs associated with the development of a licensed, nonprofit child care center. CCCDLP funds may be used to fund: acquisition; construction; renovation; capital improvements; built- in equipment; and major, outdoor play equipment (installed). Funds may not be used to reimburse expenses incurred prior to loan closing or to pay for start up costs including staffing or minor equipment purchases.

4. Applications will be accepted in accordance to the following process:

a. Providers are encouraged to attend a Program Orientation. The Orientation will provide an overview of the program, and will also offer a forum for providers to review the application and ask questions about the process.

b. Applicants will be encouraged to discuss potential project/loans with Low Income Housing Fund/Child Care Facilities Fund Staff. A Preliminary Request in the form provided as Exhibit C should be sent to the attention the Child Care Facilities Fund. LIHF/CCFF staff will review the preliminary request within one week and if deemed eligible for assistance, the applicant will be requested to submit a full application.

c. Full Applications will be accepted on an on-going basis and Low Income Housing Fund/Child Care Facilities Fund (LIHF/CCFF) staff will be available to assist applicants with applications on a one on one basis.

d. Applicants will be required to submit a completed Application along with a non-refundable application fee of $10.00. New organizations will be required to submit a business plan. Project costs will need to be justified. Site visits will be a required part of the application process. As needed, LIHF/CCFF staff will provide hands-on assistance to providers during the application process.

e. As administrator of the program, The Low Income Housing Fund/Child Care Facilities Fund will review loan requests. Working with the applicant, a loan recommendation will be developed.

f. Loan recommendations will be reviewed and approved in accordance with the program guidelines by an Inter-Agency Committee comprised of representatives from the Mayor's Office of Community Development, the Department of Human Services and the Department of Children, Youth and Their Families. Loan decisions will be made approximately four to six weeks from receipt of a complete application.

g. Upon approval, a commitment letter for a loan will be issued. Financial assistance may be conditioned on several factors possibly including receipt of other funding, obtaining necessary permits, and/or receipt of technical

assistance. LIHF/CCFF will work with applicant to meet conditions of loan closing.

h. Recipients of loans will be required to sign appropriate documents evidencing the loan, including but not limited to a Loan Agreement, Promissory Note, Deed of Trust or Assignment of Lease. If funds are for renovations/improvements to a rented property, the Loan Agreement may require a Certification By Property Owner/Landlord providing consent for the proposed project.

i. Recipients of loans will be required to provide periodic reports to the Low Income Housing Fund/Child Care Facilities Fund during the term of the financial assistance. Report frequency will depend on the nature of the project as will report content. All recipients of financial assistance will be required to submit financial statements and information on the population served on a quarterly basis and audited financial statements annually.

For additional information, please contact the Child Care Facilities Fund/Low Income Housing Fund at (415) 777-9804.

Exhibit A

Income Guidelines as of January 27, 1999

The CCCDLP must principally benefit low and moderate income persons as defined below. However, the need for assistance is greatest at the lower end of the income scale. The following scale identifies Area Median Income (AMI) income levels for San Francisco as defined by U.S. Department of Housing and Urban Development (HUD), and they are subject to change.

	1 person	2 persons	3 persons	4 persons	5 persons	6 persons	7 persons	8 persons
Extremely Low (30% of AMI)	$15,200	$17,400	$19,550	$21,700	$23,450	$25,200	$26,950	$28,650
Very Low (50% of AMI)	$25,350	$28,950	$32,600	$36,200	$39,100	$42,000	$44,900	$47,800
Low to Moderate (up to 80% of AMI)	$38,100	$43,500	$48,950	$54,400	$58,750	$63,100	$67,450	$71,800

Exhibit B

Federal and Local Requirements

Section 108 Child Care Center Development Loan Program (CCCDLP) funds are subject to numerous

federal and local requirements. Some key requirements are listed below and briefly summarized. Additional requirements can be found in OMB Circulars A-110 and A-133, San Francisco Administrative Code, The Mayor's Office of Community Development (MOCD) Operating Procedures Manual and the MOCD Bidding and Contracting Manual.

• **Audits:** agencies receiving $300,000 or more in federal funds must conduct audits in accordance with the GAO's *Government Accounting Standards*.

• **Accessibility:** programs and services must be accessible to persons with disabilities. Program access can be achieved in many cases without having to alter the existing facility.

• **Prevailing Wages:** construction workers must be paid prevailing wages under the federal Davis-Bacon Act for capital projects. Also, funded contracts cannot be awarded to debarred or suspended contractors.

• **Non-Discrimination:** agencies must comply with federal and SF Human Rights Commission prohibition against discrimination in fair housing and equal employment opportunities, and in awarding contracts. Agencies must also comply with the Equal Benefits Ordinance for domestic partners. Construction contract must have subcontracting goals for MBE/WBE's.

• **Lead Based Paint:** rehabilitation and construction activities must comply with the Lead-Based Paint Poisoning Act.

• **Local Hiring**: projects receiving CCCDLP funds over $200,000 are subject to San Francisco's Fist Source Hiring Requirement and the Department of Housing and Urban Development's (HUD) Section 3 local hiring requirement. Loan recipients must make efforts to provide training and employment opportunities to low income residents, and make efforts to provide employment information to support local businesses.

• **Environmental Review:** must be completed before funds can be utilized.

• **Procurement:** projects must comply with federal conflict of interest regulations, and regulation procedures for obtaining and contracting for goods and services. Procurement for construction contracts must be undertaken in full and open competition.

• **Ineligible Reimbursement:** funds for activities occurring prior to closing of the loan cannot be reimbursed.

• **Religious Activity:** funds may not be used for religious purposes or for the improvements of property owned by religious entities except where the loan recipient is a secular nonprofit organization with a long

term lease for the term of financing.

- **Political Activity:** funds may not be used to support political activity.

- **Proposition I :** neighborhood notification of projects under Proposition I may be required.

For more information on federal and local requirements please contact Jon Pon of the Mayor's Office of Community Development at (415) 252-3152.

Appendix G: Additional Resources

Publications

***The Business Side of Child Care: A Reference Manual for Child care Advocates and Lenders*, The Center for Community Self Help, September 1995, revised November 1997.**

***Child Care By Design: A Handbook for the Planning and Design of Child Care Centers in Massachusetts*, Commonwealth of Massachusetts, Executive Office of Administration and Finance, Division of Capital Planning and Operations, May 1993, PLU-45.**

***Child Care Needs Assessment Methodology of the Illinois Facilities Fund*, revised version, September 1998.**

***Financing Early Childhood Facilities: Investment Strategies for California's Low-Income Communities*, developed for the California Task Force on Financing Early Childhood Facilities in Low-Income Communities by the National Economic Development Law Center (NEDLC), January 1996.**

***The Future of Children: Financing Child Care*, v.6 n.2, Center for the Future of Children, The David and Lucile Packard Foundation, Summer/Fall 1996.**

Smith, Elizabeth, *Understanding child care supply and demand in the community: A child care supply and demand measurement guide*, The Enterprise Foundation; Enterprise Child Care, 1999. This document offers an on-line software tool on the methodology of supply/demand studies and is available at www.enterprisefoundation.org.

Stokley, Jan, *The Child Care Challenge for Community Development Corporations*, National Economic Development Law Center, 1990.

Stokley, Jan and Emily Heumann, "Innovative Approaches to Financing Facilities,"*Child Care Bulletin*, Issue 10, National Child Care Information Center, July/August 1996. (http://www.nccic.org/ccb/ccb-ja96/innovapp.html)

Stoney, Louise and Ann Mitchell, *Financing Child Care in the United States: An Illustrative Catalog of Current Strategies*, The Ewing Marion Kauffman Foundation and the Pew Charitable Trusts, 1997.

Watson, Sara and Miriam Westheimer, *Financing Family Resource Centers: Options, Issues and Ideas*, The Finance Project, September 1999.

Organizations

CDFI Coalition

Formed in November 1992 the Coalition of Community Development Financial Institutions (CDFI Coalition) is a policy advocacy and trade association representing more than 350 CDFIs in 50 states. The Coalition has emerged as a primary source of information for the general public, the media, public officials, and private-sector leaders about CDFIs.

924 Cherry Street, 2nd Floor
Philadelphia, PA 19107-2411
Phone (215) 923-5363
Fax (215) 923-4755
www.cdfi.org

The Enterprise Foundation Enterprise Child Care

Enterprise Child Care helps community-based organizations and state and local government to explore, create, expand, and improve child care opportunities for low-income families in targeted, distressed neighborhoods. They make loans and grants to child care providers, resource and referral agencies, community development organizations, and others for demonstration projects and for planning, developing and building child care facilities and home networks.

410 S. Michigan
Suite 928
Chicago, IL 60605
Phone (312) 341-1555
Fax (312) 786-1555
Mpiel@enterprisefoundation.org
www.enterprisefoundation.org

Local Initiative Support Corporation
Community Investment Collaborative for Kids (CICK)

Community Investment Collaborative for Kids seeks to establish state and local intermediary operations to help child care providers and other community-based organizations use resources to create high quality space for chilfren through capacity-building, training, and technical assistance.

733 Third Avenue
New York, NY 10017
Phone: (212) 455-9840
Agillman@liscnet.org

National Child Care Information Center

The National Child Care Information Cneter has been established to complement, enhance and promote child care linkages and to serve as a mechanism for supporting quality, comprehensive services for children and families. It disseminates child care information in response to requests,

publishes the Child Care Bulletin six times a year, and maintains a very helpful web site, among other services.

243 Church Street, NW
2nd Floor
Vienna, VA 22180
Phone (800) 616-2242
FAX (800) 716-2242
www.nccic.org

National Children's Facilities Network

The National Children's Facilities Network is an information association of organizations that shares information and works to advance the practice and feasibility of developing early childhood facilities serving low- and moderate- income families. The Network's members are nonprofit organizations engaged in lending or facilitating financing, real estate development services, technical assistance, policy analysis, and research and development.

List of members and contact information is on following page.

National Community Capital Association

The National Community Capital Association is a membership association of nonprofit groups that invest in poor communities. These groups borrow money from investors and lend it to finance the construction and renovation of housing, the start-up and expansion of businesses, and the provision of essential community services, including child care. National Community Capital's members make loans in communities that banks ordinarily do not, such as poor urban, rural, and reservation-based communities. The Association holds an annual conference, offers staff development training programs for its member organizations, and publishes many useful reports.

924 Cherry Street, 2nd Floor
Philadelphia, PA 19107-2411
Phone (215) 923-4754
Fax (215) 923-4755
www.communitycapital.org

National Children's Facilities Network Membership